INSIDE: A SURVEY OF PATENTS AND TECHNOLOGY

The Economist

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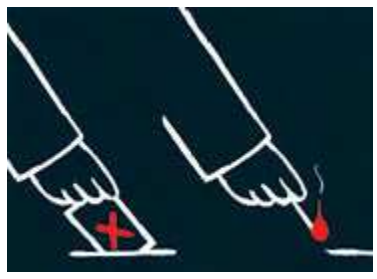

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Politics this week

Oct 20th 2005
From The Economist print edition

Iraq's referendum

A referendum on a new constitution for **Iraq** probably passed, though final results were expected later in the week. The Kurds and Shia Arabs voted massively for it; the Sunni Arabs voted against, but seemed unlikely to get the necessary two-thirds of voters in at least three of Iraq's 18 provinces to say no, which would have nullified the document. A new parliament due to be elected in December should give the Sunnis a bigger voice, but it remains moot whether that will dampen the insurgency, which is still fierce in the Sunni areas. See article

The trial of Iraq's former president, **Saddam Hussein**, began with his refusal to confirm his identity or acknowledge the court's legality, though he nonetheless pleaded not guilty to the charge of murdering 148 Shia men in a village in 1982. The case was adjourned until November 28th. See article

Reuters

After the first round of **Liberia's** presidential election, a former football star**,** George Weah, was ahead of a former finance minister, Ellen Johnson-Sirleaf; a run-off is due on November 8th.

A former president, **Milton Obote,** who led Uganda to independence from Britain, was given a state funeral in the capital, Kampala—to the surprise of many Ugandans, since he had been deposed and forced into exile by the current president, Yoweri Museveni, 20 years ago.

The **International Criminal Court** at The Hague issued its first arrest warrants—for a Ugandan, Joseph Kony, and four associates. Their Lord's Resistance Army has committed many atrocities during a 19-year-long rebellion. See article

The only show in town

America's Senate Judiciary Committee set a date of November 7th to begin confirmation hearings on **Harriet Miers's** nomination to the Supreme Court. Meanwhile, politicians and pundits pored over documents, which Ms Miers submitted ahead of the hearings, to try to establish her position on abortion.

The United States Treasury said the country's **budget deficit** for the 2005 fiscal year, which ended on September 30th, was $319 billion. The vastly improved figure (a deficit of $427 billion was forecast in February) was explained by a rise in government revenues, though there were warnings about the imminent costs of the recent hurricanes.

The **murder rate** in the United States is at its lowest level in 40 years. The Federal Bureau of Investigation, in its annual report of crime statistics based on police reports, said there were 16,137 murders in 2004, a rate of 5.5 per 100,000 people. See article

Yet another pounding

Hurricane Wilma dumped rain on the Caribbean and prompted the evacuation of tens of thousands of people as it headed towards Mexico's Yucatán peninsula and western Cuba. At least 11 people were killed in Haiti and one in Jamaica by floods associated with the storm.

Brazil's government stepped up efforts to help people affected by the worst drought in the **Amazon** basin in half a century. Low river levels have cut off many towns that depend on boats for supplies. Greens blame the drought on deforestation; government meteorologists link it to unusually high temperatures in the Atlantic Ocean, which have prompted this year's devastating hurricanes.

Reuters

Colombia's Constitutional Court upheld a law allowing presidential re-election, opening the way for Álvaro Uribe, the president, to stand for a second term next year. But Mr Uribe must await a second court ruling on a law regulating campaigns by incumbents. See article

Lucio Gutiérrez, who was ousted as **Ecuador's** president in April, renounced political asylum in Colombia and returned home to try to reclaim power. He was jailed. See article

In **Argentina**, 32 prisoners were killed after inmates set fire to mattresses in a protest over visiting hours.

Disease dissemination

The European Union said it was strengthening its protective measures against **bird flu**, and urged member states to “step up their efforts”. After cases were confirmed in Romania and Turkey, Greece became the latest country (and the first in the EU) to detect the virus. See article

Relations between **Russia** and NATO member **Norway** were strained by a naval incident. Norway's navy gave chase after a Russian trawler, boarded by two Norwegian inspectors on suspicion of illegal fishing, changed course and sped home. Russia promised to hand the inspectors back.

In the oil-rich Caspian state of **Azerbaijan**, the sacking of the economy minister, Farhad Aliyev, signalled a split in the ruling elite ahead of next month's elections. Scores of supporters of the exiled opposition leader, Rasul Guliyev, were arrested by police trying to thwart a demonstration.

Romano Prodi, **Italy's** opposition leader, hailed a “dream-like” victory after securing three-quarters of the vote in a primary designed to see who was the most popular politician on the centre-left. But the atmosphere was marred by the assassination of the deputy governor of the Calabria region. See article

Some things don't change

Junichiro Koizumi, **Japan's** prime minister, paid a surprise visit to the Yasukuni shrine, where Japan's war dead, including 14 war criminals, are remembered. Both China and South Korea cancelled planned ministerial meetings, and a summit meeting with South Korea has also been put on hold. See article

New Zealand's prime minister, Helen Clark, formed her latest government, a month after a general election. In a novel development, it will feature ministers from allied parties who do not sit in cabinet. See article

Following last week's **earthquake**, India restored telephone links across the “line of control” dividing Indian- from Pakistan-ruled Kashmir. The two sides are considering opening the line for humanitarian relief. But the number of people at risk from the quake continued to mount. There are now thought to be 3m people left homeless, many in desperate conditions. See article

Human-rights groups criticised a ten-year sentence handed to a **Maldives** opposition activist, Jennifer Latheef, who was convicted of inciting a riot in 2003.

China's spaceship *Shenzhou 6* returned to Earth after a successful five-day mission. It was the country's second manned mission.

AP

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Business this week

Oct 20th 2005
From The Economist print edition

Rotten yet robust

Refco, which saw its boss charged with fraud and the trading of its shares suspended last week, filed for bankruptcy protection. The futures and commodities broker, which had its capital-markets arm shut down, then reached an agreement to sell its key futures unit (which is still operational) to a consortium led by J.C. Flowers, a private-equity firm, for $768m. See article

The **Chicago Board of Trade**, America's oldest futures and options exchange, made its stockmarket debut on the NYSE. The initial public offering was valued at $54 a share, but CBOT's share price surged on the first day of trading, closing at $80.30.

Federal prosecutors in America brought further indictments against former executives at **KPMG**, who are accused of creating fraudulent tax-shelter schemes for wealthy individuals (the “Big Four” accountancy firm has settled its part in the case). A total of 19 people, including KPMG's former chief financial officer, have now been charged in what is thought to be the biggest-ever criminal case of tax fraud.

J.P. Morgan Chase announced that Jamie Dimon, currently the firm's president, will succeed William Harrison as chief executive at the end of the year. Meanwhile, the bank outshone a phalanx of large financial institutions that reported third-quarter earnings—its net profit of $2.5 billion was an increase of 78% compared with the same period in 2004. Other stellar results came from **Merrill Lynch**, which recorded a 49% rise in profit, **Citigroup** (35%) and **Wachovia** (32%).

Banca Popolare Italiana's share price fell by over 20% on October 19th. Concerns were raised about the value of certain assets, and the collateral on a loan the Italian bank had made to an entrepreneur. Meanwhile, the Bank of Italy approved the takeover of Banca Antonveneta by ABN Amro, a Dutch bank, bringing an end to a controversial battle that has raised questions about the probity of both BPI and Antonio Fazio, the central bank's governor.

At a loss

America's two biggest carmakers posted poor third-quarter earnings. **General Motors** reported a net loss of $1.6 billion (after losses of $1.1 billion and $286m in the first and second quarter) and **Ford** swung to a net loss of $284m. Both companies are making concerted efforts to reduce the size of their legacy costs (benefits pledged to workers) to stave off bankruptcy. See article

Eastman Kodak reported a third-quarter net loss of $1 billion, mostly due to a $900m tax charge related to restructuring. The company is trying to shift its core business away from film photography, where sales have collapsed, to digital imaging.

The Association of American Publishers filed a copyright lawsuit against **Google's** project to scan books on to the internet. The firm said the move was “short-sighted”.

America's Justice Department received another setback to its long-running litigation case against **tobacco companies**. The Supreme Court declined to hear an appeal on the amount of any award it may win in the case—it had originally sought $280 billion, but a lower court struck the amount down. In June, the department drastically cut the sum it was expected to seek from tobacco firms to fund stop-smoking programmes.

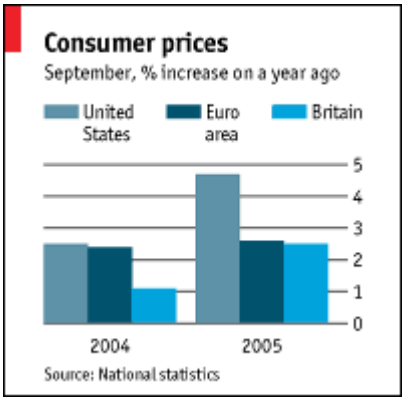
Every cloud has a silver lining

Roche reported that sales of its Tamiflu antiviral drug, touted as the best defence against bird flu, had grown by 263% in the first nine months of 2005 compared with 2004 (total drug sales rose by 20%). The Swiss pharmaceuticals group also faced some criticism for not allowing other firms to manufacture Tamiflu, but said it was ready to discuss “all available options” and would raise its production by opening a new factory in the United States. See article

Shareholders in **PetroKazakhstan**, which is listed in Canada, approved a $4.2 billion takeover by **China National Petroleum Corporation**. However, **Lukoil**, a big Russian oil firm which claims a stake in some of PK's assets, asked a judge to delay a final ruling on the deal. Last week, CNPC eased political concerns in Kazakhstan about strategic control of the country's oil assets by agreeing to sell a 33% stake in PK to **KazMunaiGaz**, which is state-controlled.

Get out the platform shoes

Britain, the euro area and the United States released figures on **inflation** that caused pundits to reach for their 1970s economics textbooks. Most startlingly, America's consumer prices rose by 1.2% in September, the largest monthly increase for 25 years. For the 12 months ending in September, consumer prices rose by 4.7%. Energy prices were blamed—the core rate, excluding energy and food, rose by only 0.1% in September. See article



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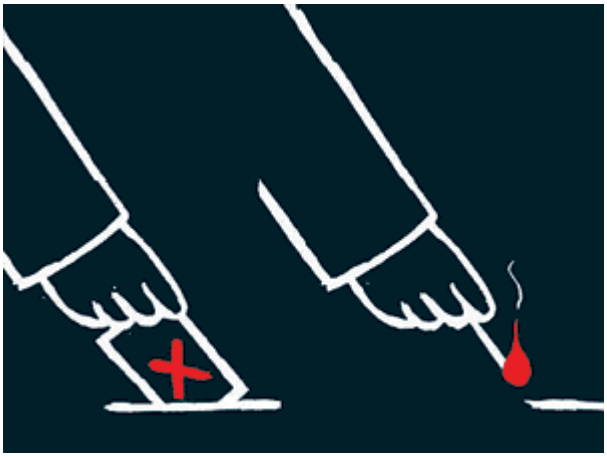
Iraq

Iraq votes, Iraq bombs

Oct 20th 2005
From The Economist print edition



Another milestone, but a long march remains before Iraq will be at peace

Get article background

THE conduct of the poll may have been questionable in some areas, and the final tally is still in dispute. But in the referendum of October 15th most of the Iraqis who voted seem to have endorsed the constitution drafted by the transitional government they elected last January. For those inclined to look on the bright side, this means that Iraq's political transition is following the official timetable. The next milestone is supposed to be another election in December, the first to be held under the new constitution, and this time for a permanent rather than an interim government, with a term of four years in which to put the prostrated country back on its feet.

Milestones and tombstones

Although the referendum is a milestone, Iraq has trudged past several such milestones only to see the bright future its people long for receding beyond the horizon. In 2004 the transfer of sovereignty to an interim government of Iraqis under Iyad Allawi was a milestone. So was the election at the beginning of this year of a transitional government under Ibrahim al-Jaafari. The fact that millions of Iraqis were willing then to defy the insurgents in order to cast their votes was an inspiration throughout the Arab world. It is excellent that they did so again last weekend, this time with many more of the embittered Sunni Arab minority taking part (see article). The opening this week of the trial of Saddam Hussein is also welcome—provided it is conducted properly. But the fact remains that conditions in Iraq are grim, and having a new constitution does not guarantee that they might not become even worse.

One reason for this is that the political process—the deal-making that takes place in relative safety behind the blast walls of Baghdad's “green zone”—is not the only thing shaping Iraq's future. The

outcome of the insurgency, and the conditions of life for ordinary people on the street, matter at least as much. And here the news is bad. In the four provinces with large Sunni populations, the insurgency is waxing strong: the Americans count hundreds of attacks every week. As for ordinary life, Dr Jaafari's government has been ineffectual. Most Iraqis have somewhat more clean water and electricity than they did when Saddam Hussein was in power and the country was besieged by sanctions, but are still short of both. Jobs are hard to find and the danger of being killed in some shooting or suicide attack empties the streets at night. This chronic insecurity deters investment, strangles hope and destroys trust in government. To dig itself out of this pit, Iraq needs to make progress on several fronts at once—not just in politics but also in economics and security. And even in politics the boon of the constitution should not be exaggerated.

The hope before the referendum was that agreement on a federal constitution might lure more Sunnis into the process and so weaken their support for the insurgents. A few of these hopes may still be realised. Many Sunnis recognise that boycotting last January's election damaged their own cause and they will not repeat the error. If they vote again in December, the government that comes into office in 2006 will at least be more representative than the present one.

But the fact that Sunnis voted in the referendum should not distract attention from how they voted. Most wanted to reject the constitution. When it comes into force in spite of their votes, Sunnis will not feel that they have been massively empowered by the ballot box. Although some who had taken up the gun may now choose another path, a hard core—whether affiliated to al-Qaeda or merely resentful of foreign occupation and the passing of the old order—will probably fight on. If they are wise, the Kurds and Shias can reduce the size of this core by handling the Sunnis sensitively. Thanks to some pre-referendum cajolery by Zalmay Khalilzad, America's ambassador, the Kurds and Shias have agreed that the constitution can still be tinkered with to soften Sunni fears. But tinkering cannot meet the basic Sunni complaint, which is that they can no longer be masters of an Iraq under majority rule.

Take a deep breath

America is now making a huge effort to train Iraqi forces reliable enough to take over responsibility for security in at least some of the safer provinces. About 30,000 Iraqi soldiers may by now be reasonably competent. But this number is still too small to take over the whole military job, and it is far from clear whether the primary loyalty of the newly trained soldiers belongs to Iraq's fledgling national institutions or to the sectarian militias from which many of them have been recruited. However weak at home, George Bush should therefore resist domestic pressure to hand over the burden and run down America's own troop levels prematurely. Creating a reliable army and dampening down the insurgency will keep America at full stretch in Iraq at least through 2006.

Another year—and then? After so much grim news, Americans are entitled to wonder whether success can ever come. Certainly, the Vietnam parallel no longer looks ridiculous: if the insurgency mutates into a full-blown sectarian war pitting Sunni Arabs against the rest, Iraq may descend into the sort of chaos from which no outsider can redeem it.

But to judge from the continued willingness of millions of Iraqis, Sunnis included, to take part in referendums and elections, that point need not arrive. And in Iraq, unlike Vietnam, America is aligned with the more powerful side: the Shias and Kurds who make up about 80% of the population and have given their broad consent to what the Americans are trying to do. The insurgency, by contrast, is drawn mainly from a portion of the 20% or so of Iraqis who are Sunni Arabs. That is still more than enough to cause mayhem; the endgame in Iraq is going to be messy. But the Sunnis do not have the strength to dislodge Iraq's majority. In circumstances like these a superpower interested in remaining a superpower needs to take a deep breath and hold

out for the year or more it will take to restore order. The Iraqis deserve no less. But a loss of nerve and a humiliating retreat might also, in the words of Osama bin Laden, turn America into a shadow of itself—with consequences that would be felt well beyond the Middle East.

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Economist.com OPINION

Avian flu

On a wing and a scare

Oct 20th 2005
From The Economist print edition

David Kjaer - naturepl.com

Preparing for an influenza pandemic makes sense. Panic doesn't

FEAR seems to be the dominant mood of the moment. Hurricanes, tidal waves, floods, earthquakes and terrorism this year have all brought with them not only appalling scenes of devastation, death and suffering, but also outrage at the lack of preparations to avoid or cope with these disasters. Now even the birds of the air are a threat, we are told. That migrating flock visible on the horizon at sunset, once a consoling reminder of the eternal rhythms of nature, could be carrying the virus which might soon kill tens of millions of people.

Given the many fingers pointed at governments in the wake of other disasters this year, it is hardly surprising that they are scrambling to respond to the threat posed by avian influenza. After confirmation this week that the H5N1 strain of bird flu, which has been spreading quickly in Asia, had been discovered in Romania and perhaps Greece, European Union foreign ministers convened an emergency meeting. President George Bush, still smarting from a torrent of criticism of his government's clumsy response to Hurricane Katrina, has promised to rush out emergency plans for dealing with an outbreak of pandemic flu which have been stalled for years. Countries around the world are hurrying to stockpile the only current antiviral drug, Tamiflu, which might be effective in saving lives in any pandemic or curbing its spread. The World Health Organisation is calling for an internationally co-ordinated effort. Health ministers from around the globe are due to meet next week in Canada to discuss what steps to take.

Is any of this effort justified? Or are politicians simply helping to feed public panic, and then covering themselves by promising to spend lavishly against a threat which may never materialise and to reduce a risk which they do not understand? To ask these questions is not to counsel complacency, but to apply the kind of test which is required in any kind of disaster planning, not least because the world is an inherently dangerous place and it is impossible to plan against every possible disaster. With the media full of warnings of impending mass death, an overreaction is all too possible.

The case against

A sceptic might point out that measures which sound plausible in the midst of general public alarm can turn out to be counterproductive. This is what has happened with the ill-conceived crackdown on terrorist finance (see article). In the case of this avian influenza, there is even less known of the scale or likelihood of the threat than with terrorism. The threat of a pandemic may fizzle out entirely. Remember all the fuss about the millennium bug? This unlikely glitch in computer software was supposed to bring the world to a halt in 2000, but it caused hardly a ripple. Even scientists who believe that bird flu will mutate into a form highly contagious to humans cannot say for certain that this will happen, or when it is likely to happen if it does, or how deadly such a new variety will be. All the key facts are not known, an exasperated sceptic would say. It could be much wiser to wait. In the 1970s the American government's overly hasty response to a “swine flu” which never arrived ended in humiliation.

These are all legitimate points, and there is undeniably a lot of uncertainty about the possibility of a pandemic. And yet it is also true that governments, companies and individuals regularly have no choice but to plan in situations of uncertainty. The trick is to do this in a way which is rational and proportionate. In the case of bird flu, most of the measures being contemplated so far can meet the sceptics' tests (see article).

The case for

Closer monitoring of poultry stocks and steps to eradicate any avian influenza outbreak by slaughtering birds should be cost-effective even if the virus does not mutate into humans, simply because of the huge economic impact of not taking action promptly, as Britain has recently learned from outbreaks of foot-and-mouth (in 2001) and mad-cow diseases (in the 1990s). Similarly, bigger human-vaccination programmes for seasonal influenza would not only increase capacity if pandemic influenza strikes, but should pay for themselves anyway because the annual costs of lost economic output to ordinary varieties of flu are already large.

Other measures are better viewed not as cost-reducing, but as a kind of insurance policy. Whether or not a catastrophic pandemic will occur is uncertain, but scientists do know enough to say that the risk is real. There were three influenza pandemics in the past century. Many scientists believe another one is overdue, and new knowledge of viruses indicates that this strain of bird flu has acquired some of the mutations it would need to be transmitted easily between humans, which has caused much of the alarm this year. If another pandemic does strike, millions could die, and hundreds of millions would fall ill within a short space of time. The loss in lives and economic output is impossible to quantify precisely, but could be enormous. So formulating clear plans about how to cope with the widespread disruption of a pandemic seems prudent, and should not be hugely expensive in itself.

More costly are plans to stockpile Tamiflu, the anti-viral drug. Most rich-country governments now want to do this, and there is not nearly enough to go around. Increasing output of this drug probably makes sense on insurance grounds, as does spending more money in the longer term on vaccine research which might make the production of new vaccines cheaper and faster, or might someday even produce one against all types of influenza, seasonal or pandemic.

The unpalatable truth is that if the current version of avian influenza turns into a human pandemic in the near future, there is probably not enough time for most countries to stop it from spreading or to cope well with its effects. Panic about this will do no good, and could do a lot of harm. But preparing now for an outbreak of a pandemic at some stage in the future does make sense. Even if the threat from today's bird flu fades, it is plausible to think that another virus, in the not-too-

distant future, may pose another threat. In an increasingly inter-connected world, viruses, like people, travel more easily.

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Counter-terrorism

The lost trail

Oct 20th 2005
From The Economist print edition

Efforts to combat the financing of terrorism are costly and ineffective

Get article background

THE best test of a regulation is that its constraints work cost-effectively against the problem it was introduced to solve. Alas, on that simple measure the elaborate efforts by western politicians, with George Bush and Tony Blair to the fore, to curb terrorism by stopping the flows of money that sustain it, must be judged a failure. Complex and unwieldy regulations have been imposed, but are not working, indeed arguably were always misguided. They should be scrapped and resources concentrated more productively elsewhere.

That might seem a harsh conclusion, even a hasty one, given that the battle against terrorism is likely to be lengthy. What if a bank monitoring its transactions could spot an imminent attack by a terrorist cell? Wouldn't that justify almost any expenditure? If lives were saved, surely the answer is yes.

Unfortunately such a scenario is mostly fantasy. Banks have been forced by onerous new compliance rules to spend hundreds of millions of dollars recording more details about almost every transaction. But they freely admit in private that their systems are unlikely to spot an impending terrorist attack. One reason is that terror funds are tiny—perhaps 1% of the dirty money that sloshes around the financial system—because it does not cost much to commit an atrocity. Another is that terrorists do not need the international banking system in order to pursue their wickedness. Indeed, they have learned to avoid it wherever possible, which is why the informal remittance systems known as *hawalas* are probably more fertile ground for the authorities than bank accounts. But over-regulation there, too, carries risks: millions of immigrants rely on *hawalas* as a cheap way to send money home.

Banks do not say any of this in public for fear of being labelled as soft on terrorists. But the

evidence is overwhelming (see article) and even big intelligence agencies admit that there is little preventive value in the flood of information being generated by anti-terrorist regulations. The only practical use of data about transactions is after an attack, when there might be some chance of tracing links in the networks that sustain terrorist movements (as there was after the September 11th 2001 attacks). But information to allow this existed before the introduction of today's massive regulatory system.

The effort is as vast as the benefits are negligible. Few outside the financial industry are aware that America alone has at least 20 federal agencies addressing terror financing. The biggest costs have been imposed on the private sector, and these are borne by millions of consumers in the form of higher fees and longer waiting times. Multiply these costs across nations, and the burden on the global economy is significant.

There is no great risk in scrapping the specific rules relating to terrorist finance. Much information will still be captured, because parallel efforts to combat money laundering will continue (and are anyway more effective). But precious resources would be freed that could be spent elsewhere, for instance in cracking down on the use of multiple identities to commit welfare and credit-card fraud. This is worth doing for its own sake and may, incidentally, also help to catch terrorists—some recent attacks have been paid for with the proceeds of such fraud. However, loading down the world's financial system with a heavy new regulatory burden makes little sense. Politicians have rushed into this as a way to look as if they are taking bold action against terrorism. But this particular effort is misconceived and pointless.

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Economist.com OPINION

Russia and the Caucasus

Try being tender as well as tough

Oct 20th 2005
From The Economist print edition

Russian policy could still alter—and avert a catastrophe

THE very fact that the latest flaring of violence in the north Caucasus could be seen, in Moscow, as a "success" is a mark of how drastic the situation in Russia's most volatile region has become. Yet because more insurgents were killed, and fewer police and soldiers, than in a similar spectacular last year, some in Moscow seem pleased with the outcome of last week's rebel assault on the city of Nalchik. It was, actually, a disaster: hundreds of armed men infiltrating and rampaging around a regional capital. President Vladimir Putin talked about "our" losses and "theirs"; but the attackers were citizens of Russia too. Worst of all, although the facts are still sketchy—and are likely to remain so—it seems that most of them came from Kabardino-Balkaria, the semi-autonomous republic of which Nalchik is the capital, not from nearby, war-ravaged Chechnya: the Nalchik-based Islamist group implicated had hitherto been considered relatively minor. After Nalchik, it looks as though the Caucasian Cassandras, who warn of instability engulfing the entire region, are being vindicated.

Many Russians were understandably angered by western responses to last year's atrocity in Beslan in North Ossetia, another north Caucasian republic. Too little blame was placed where, in the first instance, it belonged—on the terrorists. Ditto the Nalchik rampage last week (though the fighting rumbled on into this week, and Russian servicemen were also killed in Chechnya and its already-anarchic neighbour, Dagestan). Though it largely eschewed civilian targets, the Nalchik attack killed (including the perpetrators) well over 100 people, partly in pursuit of a goal that is neither shared by most local people nor obtainable. The insurgents will never achieve their aim of a pan-Caucasian caliphate. They might, however, create pan-Caucasian chaos: a catastrophe for Russia and far beyond.

What is to be done?

All the same, Russia and Mr Putin share the responsibility, for three reasons. The first is the brutality and lawlessness of Russia's security services, who kill, kidnap and torture in Chechnya and across the region, inciting vendettas and radicalising relatives. The Nalchik raid was preceded by years of police harassment of young Muslims, and the closure of all mosques other than the state-sanctioned one. The second reason is the Kremlin's approach to regional government—which, in the north Caucasus, has involved supporting pliant but unpopular bosses. The Kremlin's embrace of Ramzan Kadyrov, warlord-cum-deputy prime minister of Chechnya, is only the worst example of this.

A third reason is the corruption that blights the Caucasus even more than the rest of Russia (see article), and which Mr Putin has done little to confront. Corruption in the army is a big part of why war in Chechnya has proved so interminable, and why life remains so dismal for ordinary

Chechens. It also helps explain why terrorists can move round Russia with mystifying ease. The corrupt monopolisation of wealth, and bullying of rival business, also lurks behind the unemployment that drives young men towards fanaticism.

Fatalistic observers blame these problems on the north Caucasus's wretched past, with its ethnic rivalries, incessant wars, the deportation of entire nations by Stalin, and the Soviet mixing of fractious peoples into unnatural administrative units. But history need not continue to repeat itself.

Given its location, and the role it plays in global jihadist rhetoric, the world should be more concerned about the north Caucasus. Yet Russia's aversion to foreign meddling means that there may be little outsiders can do. There are, however, elementary steps that Mr Putin could take. Chief among them must be a real effort to stop the brutality of the security services, beginning with serious prosecutions of kidnappers and murderers. More generally, the peoples of the north Caucasus must be persuaded that politics in Russia will let them address their problems peacefully. To that end, the Kremlin must ensure that the local elections to be held in Chechnya next month are seen to be freer and less rigged than previous Chechen votes. Using force to bind in the Russian empire's most fissiparous area has only spread misery. Democracy, if Mr Putin will only try it, might work better.

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Economist.com OPINION

America and a nuclear India

Bend them, break them

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From The Economist print edition

The dangers in breaking the anti-nuclear rules to please India

Get article background

FROM George Bush to a unanimous UN Security Council, all agree that the spread of weapons of mass destruction is a dire threat to peace and security. In an all too fissile world, Mr Bush has made the anti-proliferation fight a centrepiece of his foreign policy. He aims to lever North Korea out of the bomb-building business, and to part Iran and others with dubious nuclear ambitions from dangerous bomb-useable technologies. America leads a posse of governments in disrupting illicit trade in nuclear, chemical and biological materials. The Security Council has outlawed their transfer to terrorist groups. So why would Mr Bush risk knocking the stuffing out of the Nuclear Non-Proliferation Treaty, the legal bar to the spread of the bomb, by offering to help NPT-outsider India hone its nuclear skills? Congress, among others, now wants answers (see article).

Mr Bush says the bargain he struck with India's prime minister, Manmohan Singh, in July does three good things. By offering civil nuclear co-operation, denied for decades, America hopes to cement its growing friendship with a peaceable democracy in a tricky neighbourhood. Not only that, but India will take on similar anti-proliferation commitments to the NPT's official nuclear five (America, Russia, Britain, France and China). Though India built a secret arsenal, then conducted weapons tests in 1998, America will still not formally recognise it as a nuclear power (calling it a “responsible state with advanced nuclear technology”) and promises not to help its bomb-tinkering. Lastly, more nuclear energy will allow India to power its economy without damaging the environment.

The trouble is that in order to sell India nuclear fuel and other technologies, Mr Bush wants to reverse a 30-year effort, both by America's Congress, which takes a hard look at the deal later this month, and by the 45-nation Nuclear Suppliers' Group, which met this week, to demand full-scope safeguards (meaning checks on all nuclear installations, which India does not allow) as a condition for nuclear supply. Drop that condition for India, which has boycotted the NPT, and it

becomes harder to justify for countries that have played by the treaty's restrictive rules (or even those like North Korea and Iran who joined but haven't) to gain similar civilian benefits. Meanwhile, Britain, France and Canada have said they will loosen some of their rules for India too. So will Russia. Pakistan, another NPT-holdout, is demanding similar concessions.

Fix it, don't break it

Ironically, India wants civilian help because the rules were working: it is short of uranium for existing power plants (though many Indians, still burning dung and wood, will not benefit from more expensive dollops of nuclear power). Yet its power industry is closely bound up with weapons production: its first “peaceful” nuclear explosion, in 1974, used plutonium extracted from spent fuel with technologies supplied for civilian purposes. It now says it will try to separate more of its civilian from its military installations and let inspectors in, but there are no agreed criteria: India will decide the list.

As for other commitments, India promises to tighten export controls, but that is already a UN requirement. Since Mr Bush won't ratify the treaty banning all nuclear tests, he won't press India to either (though it has reiterated its commitment to a moratorium). India has agreed to work with America for a treaty to cut off production of fissile material, but both know talks have been stalled for years. And India refuses to adopt a voluntary ban, as America, Russia, Britain and France have done (China is thought to have too, but won't say it), because it wants to build lots more bombs. Without such a ban, whatever Mr Bush claims, nuclear skills, equipment and materials for India's civilian industry will help ease the choke points in its military programme too.

Isn't the burgeoning friendship between the world's richest democracy and its biggest one a strategic benefit that outweighs the potential costs? Mr Bush might think so, eyeing India's large neighbour, China. Better relations are worth having, but India has made quite clear it has no intention of being played off by America against China or anyone else.

Sorting out which nuclear materials it is sensible to sell, under what conditions and to whom, is going to get harder. Many countries see nuclear power as a way to meet demands for cleaner energy. Like India or Iran, all will need fuel that could be misused for bomb-making, so new rules are needed. But unless they are based on fairness to those who keep them, not favouritism to those who don't, they will deter no one.

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Economist.com OPINION

Global inflation

The scourge returns

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From The Economist print edition

Central banks cannot ignore the latest spurt in inflation

KARL OTTO PÖHL, a former president of the German Bundesbank, once remarked that “inflation is like toothpaste. Once it is out of the tube, it is hard to get it back in again.” Apparently not that hard. Until recently it looked as if inflation had been defeated in most rich countries. But it has risen sharply this year in America, the euro area and Britain. America's inflation rate has almost doubled over the past year to 4.7% in September, its highest since 1991. Embarrassingly, inflation is now higher than when Alan Greenspan, the soon-to-retire chairman of the Federal Reserve, took office in 1987.

British inflation is equally embarrassing for the Bank of England. It has risen from 1.1% to 2.5% over the past year, well above the Bank's 2% target and the highest rate since 1996. The average inflation rate in the G7 countries now stands at an estimated 3.2%, its highest for 13 years. Excluding Japan, where consumer prices continue to fall slowly, the average inflation rate is 3.7%. This is hardly hyperinflation, but it is also not most people's idea of price stability.

The Fed, the European Central Bank and the Bank of England are suddenly sounding more hawkish. It is true that the leap in inflation is largely due to higher oil prices, and the core rate (which excludes oil) remains tame in most countries. But central bankers are worried that higher oil prices could feed into other prices and wage demands. According to a closely watched survey by the University of Michigan, American consumers' expectation of inflation 12 months ahead jumped to 4.6% in early October from 3.1% in August.

How should the guardians of the world's money respond? The conventional wisdom is that central banks should focus on core inflation, since oil prices are affected by temporary supply shocks. But the rise in crude oil prices over the past few years has largely reflected strong global demand rather than a disruption to oil supply, and the futures markets think that most of the rise is permanent. If so, it will eventually affect core inflation. Moreover, the headline inflation rate, including oil, matters because it is the one that consumers experience, and so can influence inflation expectations and wage claims.

A central bank cannot prevent oil prices giving a one-off boost to inflation, but it can try to prevent this feeding into higher wages and prices. To ensure that the rise in inflation is only temporary, central banks need to increase interest rates at least in line with inflation. If central banks hold interest rates unchanged as inflation rises, this would imply lower real rates and hence an easing of monetary policy. Global monetary policy is still unusually lax by historical standards. In America, despite 11 increases in interest rates since June 2004, real rates are still negative and below any reasonable notion of the “neutral rate of interest” at which monetary policy is neither stimulating nor restraining the economy. In other words, the Fed will need to keep pushing up interest rates into 2006.

In the euro area, real interest rates are also negative and at their lowest in history. So it is hardly surprising that the ECB has started to hint that it may need to raise interest rates. In Britain, where spending has slowed sharply over the past year, rising inflation is more likely to delay rate cuts than to trigger an increase. Mervyn King, the governor of the Bank of England, gave warning last week that monetary policy must focus on inflation and can do little to counter the slowdown.

A reversal of fortunes

On top of the impact of higher oil prices on inflation, there is another reason for central banks to remain on guard. Over the past decade, central banks have had a big helping hand in holding down inflation from faster productivity growth in some countries (thanks to information technology), and from the integration of China into the world economy. By increasing the world economy's growth potential, these factors allowed America in particular to grow faster without inflation. At some point, the impact of IT and China on inflation could fade or even go into reverse (see article). If this happened at the same time as a surge in oil prices, inflation could take off more quickly than it has for many years.

That is not a reason for central banks to push interest rates up sharply today. But if house prices and consumer spending stumble, neither should central bankers slash interest rates as it is now widely expected that they would do. As long as inflation remains well above central banks' desired targets, they would be wrong to cut rates. That would be to turn a blind eye to history. The bitter experience of the 1970s shows that the first signs of rising inflation should never be ignored.

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On the internet, manufacturing, Ajax, Airbus, donkeys, Medicaid, political ideas, intelligent design, Delphi's bankruptcy, credit quality

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From Economist.com

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Spinning the web

SIR – The conclusion of your leader on internet governance takes an unnecessarily cynical view on the proposal to set up a forum to discuss difficult subjects by saying it is merely a talking-shop that has been created to avoid the real issues ("America rules OK", October 8th). In fact, the proposal would create a new and neutral space for dialogue among all interested parties. In particular, developing countries feel that they are left out of current arrangements. While the forum's lack of teeth may be a comfort to some, it is not the essence of the proposal—rather, it is for thoughtful dialogue on difficult issues among many stakeholders.

Markus Kummer
Secretariat of the Working Group on Internet Governance
Geneva

SIR – The Internet Engineering Task Force sets a wide range of technical standards, and the Internet Corporation for Assigned Names and Numbers co-ordinates policy for only two aspects of them: top-level domain names and numeric addresses. Unfortunately, the whole debate about internet governance under the auspices of the United Nations has for some reason focused on relatively minor technical issues, which hardly deserve being called "governance", and has passed by in silence on more important issues, such as freedom of information, the right to privacy, affordability of internet access, and other issues worthy of international diplomacy.

Brian Carpenter
Internet Engineering Task Force
Geneva

Labour pains

SIR – Your leader on the loss of manufacturing jobs underplays the social cost ("The great jobs switch", October 1st). Since the peak in manufacturing employment in the mid-1960s, male employment rates have fallen, hitting bottom in the early-1990s. This fall was matched by an increase in dependency on state handouts (disability benefits in particular), property crime and family breakdown. All of these problems have hit record levels since the 1960s. The difficulty is one of relative pay as well as job availability. A man with a job in a car factory in the 1960s could afford to buy a house and bring up a family in reasonable comfort, unlike a low-skilled worker today who is likely to be dependent on state top-ups. No one wants to stop the gains from trade, but we need to address the problems in our education systems, which turn out far too many people inadequately equipped to compete in a world where muscle is no longer a valuable

commodity.

John Ball
London

SIR – Although western countries still maintain a strong competitive advantage when it comes to technology-intensive jobs, the gap is closing fast. And unless you believe that Europeans or Americans are intrinsically more intelligent or imaginative than their southern or eastern counterparts, western R&D departments too will be strained by cheap labour from abroad.

Philippe Beinaerts
Antwerp, Belgium

Illiterati

SIR – As an inhabitant of Amsterdam employed in IT, I am fairly confident that the “Ajax” you refer to as the top topic on the Technorati search engine for blogs is not our local football team, but is in fact the acronym for Asynchronous JavaScript and XML, the latest hype in website development (Face value, October 8th).

Matthijs Breebaart
Amsterdam

No free launch

SIR – Your profile of Gustav Humbert, the new chief executive of Airbus, provides an interesting look at the company (Face value, October 1st). However, you make one point that ignores simple economic reality. You say that Airbus “achieved profit margins superior to those of its competitor; a feat that was quite independent of its controversial state aid.” Not so, according to Mr Humbert's predecessor at Airbus, Noël Forgeard, who is now co-chief executive of EADS. In a recent newspaper interview, Mr Forgeard was cited as saying that the profitability of the new A350 would be “destroyed” without launch aid. And Mr Humbert himself stressed at this month's formal approval of the A350 that, yet again, the Airbus partner governments had signed “legally binding” commitments of financial launch support for the project.

Launch aid (which amounts to billions) defies international trade rules and boosts the profitability of Airbus by allowing it to avoid the full expense, and risk, of developing a new aircraft. Low rates and generous terms further reduce the expense for Airbus. And lower expenses lead to higher profits. In short, ignoring the significant role launch aid plays in the profitability of Airbus is akin to saying that an aeroplane's lift is quite independent of the influence of its wings.

Ted Austell
Vice-president for international trade policy, Boeing
Arlington, Virginia

Whose fault?

SIR – In reference to your article highlighting the dangers of sleeping donkeys on highways in Namibia, I wonder if the accidents can really be put down to the assphalt? (“Donkey business”, October 8th).

Holger Veith
Geneva

Health care

SIR – Your blatantly conservative discussion on Medicaid sorely lacked a thorough analysis ("Swamped", September 24th). You painted the federal-state health insurance plan as an excessively lavish government programme that wastes taxpayers' money by enrolling wealthy participants who could be covered by private insurance. In fact, because America's health insurance system is based on sound employment, the poor (and near poor) cannot get affordable coverage. This is why Medicaid was enacted—to cover a gap the market will not fill. It is true that some states provide more generous benefits, but that is not the norm, nor is it consistent. The funding and eligibility for Medicaid fluctuates in tandem with states' budgetary woes. In tough times the first cost-saving step they routinely take is to cut the programme's funding.

Josh Kohrumel
San Diego, California

Thought deficit

SIR – Lexington challenges anyone to "name a single exciting Democratic idea" (October 8th). Well for starters, how about rolling back most of George Bush's irresponsible tax cuts that account for one-third of our deficit?

James Rudolph
La Jolla, California

SIR – It is Republicans who are currently in trouble because of the bankruptcy of their own ideas. The "small government" mantra has proved to be nothing but a dated and self-serving rebel yell.

Samer Kurdi
Seattle

From Adam, about Eve

SIR – It may be small comfort to evolutionists, but my wife assures me that I am evidence against intelligent design ("Life is a cup of tea", October 8th).

David Unger
Toronto

ONLINE ARTICLES

The following correspondence refers to articles published only online

Delphi's bankruptcy

SIR - In your article on the bankruptcy of Delphi, you correctly attribute General Motors' and Delphi's financial troubles to the stubbornness of the United Auto Workers as well as to the uncontrolled spending spree of the late 1990s. However, you omit another major factor: negligence. It is almost inconceivable that a powerful and respected company such as GM would fail to see five years into the future. Having hundreds of thousands of employees, how could they not see the strain on oil refineries, or the increasing presence and acceptance of hybrid and Japanese cars? How does a company go from being one of the most profitable in the world to being almost bankrupt in six years? By being negligent in a business with no room for such colossal mistakes.

Arturo Núñez

SIR — As for GM (and Delphi), your article curiously glosses over the interests of the people they build those vehicles for, i.e. the customer. It has been calculated that some $1,500 of the sticker price of each GM car goes towards worker pension and medical benefits. In effect, then, it is the unsuspecting car buyer who is shouldering the costs of those sweetheart deals GM worked out with the UAW years ago. Ask yourself: what kind of idiot would ever buy a GM car, knowing that he or she was subsidising the company's benefit plans for its workers? Or, maybe P. T. Barnum was right after all: perhaps a sucker is born every minute!

Gerald Graham

SIR — With reference to the issues that Delphi and GM face on their liabilities to their pension funds, as one reason you mention the inadequate investment during the good stockmarket times. Instead that money was funnelled to other uses. This kind of moral hazard on the part of companies' management should not go unpunished. Where is the remedial measure or penalty for this callousness on the part of management which shows up so often? Give skilful executives (not the lucky ones) good rewards, but penalise them heavily for bad decisions. Only then we will know across the board who showed skill and who was lucky.

Dr Atanu Sinha

SIR — Pensions contributions should be paid direct to the federal Pension Benefit Guaranty Corporation, not held by the companies that played accounting games with the money.

Joseph Monek Jr

SIR — I fear that Buttonwood has swallowed the bait of Delphi's Mr Miller hook, line and sinker: the issue of Delphi's pension-fund liabilities has little if anything to do with a "clash between the interests of young workers and those of their predecessors" and everything to do with the failure of one party in a commercial agreement to honour its undertakings to the other. The fact that those undertakings were given some time ago, and thus may be qualified as "legacy", is surely irrelevant?

As an employee of a major corporation, I made an agreement when hired (subsequently updated) which covered my duties and responsibilities to my employer; and in return laid out the duties of my employer. Salary, pension, health care, stock-purchase plan and the rest were part of "the package". When deciding to join (and stay with) my employer, I weighed each in the balance. Some commitments (my pay check) were of a short-term nature, others (pension accrual) run over the whole length of my employment. Simply put, the commitments, once made, should be honoured.

All of this has absolutely nothing to do with "inter-generational warfare"—it is a straightforward commercial agreement between my employer and myself. Shame on Buttonwood for letting Mr Miller off his own hook.

Peter Edwards

Credit quality

SIR — In reading your most recent Buttonwood, "A Hole in the Middle", I was overcome by culinary nostalgia, having been raised in the United States. I now live in the UK and as a veritable doughnut connoisseur, I truly miss the cheap and sugary pleasures (oh, so creamy, too) of my homeland. Sometimes I wonder why chains such as Dunkin' Donuts and Krispy Kreme haven't made a success in the UK. Strange spellings aside, perhaps it's the sheer scale of self-indulgence that separates us Americans from our British cousins. Perhaps also, the same could be said about our free and easy consumer-credit culture. My English wife was amazed and appalled at the number of credit cards she was offered while living in Philadelphia. All this without even having a bank account. Tellingly, she also did not like Krispy Kreme doughnuts.

Ryan Notz

SIR — I'm extremely surprised that you didn't mention the effects of Hurricane Katrina on American credit markets. You have to imagine that the thousands of displaced people with no income or significantly reduced income is going to have a large impact on defaults in all of the American debt markets. In many cases, secured debts will be heavily damaged or destroyed and the lender will be left with nothing. I think that this in addition to the bankruptcy bill is going to drive credit quality in the next year or two.

Cliff Helfer

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Iraq's referendum

Out of bloodiness, a certain hope

Oct 20th 2005 | BAGHDAD AND CAIRO
From The Economist print edition

Getty Images

The vote on a draft constitution will not improve things immediately. But it has changed the political picture

Get article background

LAST Saturday, for the second time this year, an uncanny calm settled over the cities of Iraq. A traffic ban, designed to stop car-bombers, emptied Baghdad's avenues of vehicles. Families took advantage of a rare opportunity to go out, not just to cast ballots but to chat with neighbours or simply walk the streets.

In January citizens were voting to elect their first post-war parliament; this time they were casting ballots for or against the draft of a constitution, largely drawn up by the Shia Arab and Kurdish parties that dominated the earlier elections. In many Shia and Kurdish parts of the country, where most people are thought to have supported the charter, there was much less excitement than in January. This was partly because the constitution was viewed as a sure thing, but also because few unreservedly welcome its patchwork of compromises. Many voted yes in the simple hope that the document would bring stability, ending the short-lived interim governments and, with them, the aimlessness afflicting the country.

Among the Sunni Arabs, the opposite was true. In January, they largely stayed away from the polls because of insurgent threats and a boycott called by their religious leaders, who said that there could be no elections under occupation. Sunni leaders now think this was a mistake. It cost them influence when the constitution was drafted, turning it into a Kurdish-Shia project that may split the country or, as some see it, lead to an Iranian takeover of part of it. So the Sunnis turned out this time in droves and are thought to have overwhelmingly voted no.

Final results are not expected until this weekend at the earliest, but most suppose that the constitution will pass. The no voters need to get a two-thirds majority in at least three of Iraq's 18 provinces to block it. They are likely to have done so in the almost entirely Sunni Arab governorate of Anbar and heavily Sunni Arab Salaheddin. Early reports from the more ethnically mixed swing governorates of Nineveh and Diala, however, suggest an unexpectedly high yes vote—so unexpected that many Sunni leaders think the ballot-boxes were stuffed by Kurdish and Shia leaders.

A clear and clean victory for the yes camp now seems out of the question. A close victory might not be much better, indicating that there is no national consensus on what the constitution should be. A defeat for the draft might give the Sunnis a sense that they are not completely sidelined, but it would lead to another year of weak transitional government and the possibility that there may be no vision of the country on which all can agree.

If the constitution passes, it will be followed by new parliamentary elections in December for Iraq's first permanent post-war government. In practice, however, there will still be problems to resolve. As part of a deal that was supposed to bring some Sunnis on board, the constitution must be revisited and amended and a number of blanks filled in. They include details on the formation of new regions, of which one, Sunnis fear, may be a Shia “super-region” of perhaps as many as nine provinces; the sharing of oil revenues, of which an extra slice may go, for a while, to the neglected south; and the distribution of revenue from oilfields found in future. The statutes governing Iraq's supreme court must also be decided.

On the bright side, the high Sunni turnout suggests that most think it is now worthwhile to take part in elections, even under occupation. Their mobilisation should lead to two things. First, it should establish which Sunni leaders actually represent the community, and make it easier for Shia and Kurdish leaders to talk to them. Second, it should bring a strong Sunni Arab contingent into parliament. Most of them are likely to be nationalists, many with old ties to the Baath party, rather than secular liberals or the Iraqi Islamic Party. Such a block in parliament could change current counter-insurgency tactics; most Sunni leaders are strongly opposed to American raids in their cities.

The constellation of parties governing Iraq will also probably change with the new elections, although the prime minister is likely to remain a Shia. Kurds, Sunni and Shia Arabs alike are disappointed with the weak and dull Ibrahim al-Jaafari, the current prime minister, who comes from the Islamist Dawa party. Dawa's rival for the Islamist vote, the Supreme Council for Islamic Revolution in Iraq (SCIRI), has stronger grass roots, enjoys close ties with the influential Grand Ayatollah Ali al-Sistani, and may make a bid for the premiership. The former prime minister, Iyad Allawi, a secular Shia leader, would like his old job back, although his support of the constitution may hurt him with the Sunnis. Meanwhile Ahmed Chalabi, a maverick (and previously secular-minded) Shia leader, has been courting Muqtada al-Sadr, a radical Shia cleric, and is also eyeing the top post.

Iraq's Sunni neighbours may belatedly be adjusting to events. By bringing the Sunni Arabs, even grudgingly or by way of protest, into some form of political process, the referendum provides the neighbours with a fig-leaf for greater engagement. Many of them—especially Turkey and Syria, with their large Kurdish populations, but also Saudi Arabia, Kuwait and Bahrain—are anxious to try to keep Iraq within the Arab fold and to protect it from Iranian influence. A visit this week to Baghdad by the secretary-general of the Arab League may bestow a bit more legitimacy on the Iraqi government.

The limits of authority

In terms of how Iraq is actually governed, however, neither the elections nor the new constitution will make much immediate difference. Throughout the country, the power of the central government—and in some places, of any government—is feeble. Kurdistan will remain firmly under the control of its regional government, now headed by Massoud Barzani of the Kurdistan Democratic Party (KDP) thanks to a pact by which his rival, Jalal Talabani of the Patriotic Union of Kurdistan (PUK), who is also Iraq's president, represents the Kurds in Baghdad. Most Kurds say they dream of full independence, but accept that it is not yet feasible. Iraq's neighbours dislike the idea of a Kurdish state and, perhaps more important, Kurdistan is economically dependent on the oil revenues it gets from the central government.

Although their region is comparatively secure and well governed, some Kurds are fed up with their KDP and PUK leaders, each of whom rules a section of the zone. In September, riots broke out in the town of Kalar after police tried to break up a demonstration of mostly young Kurds angered by shortages of gas, fuel and power. However, most Kurds will rally to their traditional parties as long as they still perceive a threat to their interests from the south. A plan to merge the rival KDP and PUK administrations might improve governance, but never quite seems to happen.

Just to the south of the Kurds' self-rule zone lies the disputed and oil-rich province of Kirkuk, which Kurds dearly hope to recover. According to an agreement reached between Iraqi leaders in March 2004, a government commission will supervise the return of Kurds and other non-Arabs driven from the province under Saddam Hussein's “Arabisation” policy, after which the residents will vote in a referendum on whether or not to join the Kurdish Region. According to the new constitution, this must be done by December 2007. It may yet encounter resistance from Turkomen and Arabs in the province.

The Shia parts of the country, including the southern provinces and the eastern slums of Baghdad, are comparatively free of political violence but still remain highly unstable. In the big cities, political and religious movements and their armed followers command more authority than the state. A spat last month between British troops and fighters loyal to Mr Sadr shone light on the extent to which militiamen had corrupted Basra's police. After arresting two British soldiers, policemen refused a government order to release them, instead handing them over to the Sadrists.

The 4,000 British troops in Basra province have since increased their efforts to extract the worst policemen, especially those setting off roadside bombs against them. But there are no plans to retrain the remainder of the force, which is weak and mostly incompetent. If Mr Sadr's boys were to resume the insurgency in the south that flickered last year, the police would probably crumble before it.

In smaller towns, the police forces and local government are often merely an arm of one particular party, usually the Sadrists or SCIRI, or a local tribe. Corruption is rife, with many officials implicated in the smuggling of Iraq's subsidised petrol to its neighbours. Tribesmen specialising in kidnapping for ransom prowl the roads, and even the occasional river pirate patrols the waterways between Basra and the sea. Iran, meanwhile, is reported to be spreading its money freely in the area in an attempt to buy influence, and many secular southerners worry that federalism will turn their part of the country into a mini-theocracy under the aegis of Iran.

A tally of violence

The Sunni Arab heartland is the most chaotic, with insurgents paralysing government in many towns. Even more than in the south, tribes are thought to be the only functioning institution in many parts of western and central Iraq, particularly in the more isolated and conservative towns of the Euphrates valley. This may change, however, if the elections create a credible Sunni Arab nationalist movement in parliament. Next year some genuine interlocutor between the Iraqi government and the more nationalist rebels may emerge. However, the guerrillas will still have grievances, some radical Islamists will still reject parliamentary politics outright, and there will still be criminal gangs who have merged insurgency with other pursuits and made it a paying proposition.

The high turnout among Sunnis, if only to vote against the constitution, has raised hopes that some insurgents and their supporters may now be weaned off violence. American officials have also claimed that some Sunni nationalists are now repelled by the beheading tactics of their extremist allies. Sunni tribal chiefs in western Akashat, near the Islamists' strongholds along the Euphrates valley, recently sent 175 of their sons to join the national army.

Yet the Americans have been making similar claims for well over a year, in which time the insurgency has deepened and spread. Indeed, given its ferocity before the poll, with around 450 people killed in the previous two weeks, it seems likely that some Sunnis resumed shooting at Americans directly after casting their no vote. For their part, American forces in Anbar, the most violent province, also swiftly resumed normal business after the poll. On October 17th, two days after, American air strikes near the town of Ramadi killed 70 people, including, according to some reports, women and children.

Such tactics may hurt the enemy in the short run, but over the course of the occupation they have damaged America's cause. In Anbar, most towns west of Ramadi are in insurgents' hands, except during and immediately after occasional, devastating American strikes. This month has seen a flurry of such attacks, including Operation Iron Fist, a six-day offensive close to the Syrian border that left 50 alleged insurgents dead. After a concurrent sweep through Haditha, another town in the valley, two Iraqi army battalions were installed nearby. This was rare progress but, as untested light infantry, they will need full American support, with armour, air power and logistics, for another year and more.

In less violent parts, more Iraqi troops have been pitched into the fight. Though only one or two Iraqi battalions operate independently of coalition troops, more than 100 are deemed ready to some degree. The leading part Iraqi soldiers played in fighting in Tel Afar, in northern Nineveh, last month compared well with the rearguard role they took in the battle for Fallujah last year. By flooding Baghdad's streets with 40,000 mostly Shia soldiers and police in June, the government showed that it could, temporarily, improve security there. But many have since been withdrawn—partly because of their alleged abuses against Sunnis—and bands of armed insurgents can again be seen strolling the pavements, if not storming police stations as they did last year.

In another encouraging sign, the number of suicide attacks is down to fewer than 50 a month, from well over 100 in April and May. Optimists claim that credulous fanatics must be in short supply; they point also to the recent use of women and lily-livered men, such as the terrified Somali who leapt from his bomb-primed car and surrendered to American troops. Wiser heads urge caution. The springtime spate of suicides followed a similar lull, for which similar wishful claims were made.

Fortunately, really serious carnage prevails in only four of Iraq's provinces. Most of the other 14 are relatively peaceful—which is one reason why they may push for autonomy and separation from

the resource-poor and murderous Sunni region. The draft provides for this by allowing the regions to manage their own internal security. This was necessary, to allow the suspicious and long-autonomous Kurds to maintain their *peshmerga* militias. But it also plays nicely to the feuding Shia Islamists whose militias partly, and much more chaotically, control much of the south.

The British prefer to talk about the Iraqi army division they are training, which, in the absence of insurgency, has made good progress. By the middle of next year, on recent form, southern Iraq will have less power, less clean water, a less productive oil sector and a less competent police force than before the allied invasion. But it will have 10,000 locally raised and trained troops. And, in the absence of terrific violence, the British might then feel justified in quitting Iraq, at least its southern part. If they do not do so, it will be mostly because they wish to keep America sweet.

And the country itself? Iraq will probably stay united in name but may evolve in fact into at least three mini-states: stable, crony-ridden Kurdistan in the north, the messy south and the utterly anarchic centre and west. Whether these mini-states can resolve their differences depends largely on whether or not their leaders agree to compromise with each other in a reasonably democratic manner, and whether they can divvy up oil revenues in a way that keeps everyone fairly content. If Iraq's three main communities ultimately decide they need to work together, the country may perhaps evolve into a fragile, probably corrupt, but viably federal state. That should, at least, be better than Mr Hussein's tyranny or today's mess.

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Saddam Hussein

A court on trial

Oct 20th 2005
From The Economist print edition

Iraq's former dictator in the dock at last—all too briefly

Reuters

Unrepentance personified

Get article background

MORE than a year after Iraqi government officials began announcing the imminent start of Saddam Hussein's trial, the former Iraqi dictator at last appeared before the Supreme Iraqi Criminal Tribunal on October 19th, charged with responsibility for the massacre in 1982 of more than 140 civilians in the predominantly Shia village of Dujail, north of Baghdad. Given Mr Hussein's involvement in far more heinous crimes, including the gassing, slaughtering and torturing to death of some 300,000 of his fellow Iraqis, it may seem odd to have started with a minor case. But it was the easiest to prepare, and the government is eager to get Mr Hussein out of the way—if possible, before the general election due on December 15th.

The outcome of this and 11 other cases to be brought against the former dictator is regarded as a foregone conclusion. His sentence, likewise, is considered already signed and sealed: death, by hanging or by firing squad (the usual means for military officers). But how this and the other trials will proceed is far less predictable. Already there have been questions about the court's vulnerability to political interference and its ability to provide a fair trial in accordance with international law. Last month, President Jalal Talabani, a Kurd, claimed on state television that Mr Hussein had already “confessed” to ordering the massacre of some 100,000 Kurds during the infamous 1988 Anfal campaign. “Saddam should be executed 20 times,” he said.

At the outset of this week's proceedings, a cocky Mr Hussein challenged the court's legitimacy. “Who are you and what do you want?” he demanded of the five-judge panel. Insisting on his “constitutional rights as president of Iraq”, he refused to recognise “the entity that authorises you”. In a clear hint that he intends to challenge the legality of the Iraq war, he added: “Aggression is illegitimate and what is built on illegitimacy is illegitimate.” He pleaded not guilty to all charges.

Set up in December 2003 by the American-backed Iraqi Governing Council to try Mr Hussein and his former lieutenants for genocide, war crimes and crimes against humanity, the court differs from other war-crimes tribunals in having no international judges or (at present) even advisers, failing to require proof of guilt beyond reasonable doubt and including the death penalty among its sanctions.

At first there were fears that the process, dominated by the Americans, would be seen as “victors' justice”. But attempts by rival Iraqi factions to control the court are causing more concern. Successive Iraqi governments have urged the court to speed up proceedings in an attempt to win political advantage. They are likely to be foiled again; the court has adjourned Mr Hussein's trial until November 28th, since too many witnesses were afraid to turn up.

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Diplomacy and proliferation

Nuclear confusion

Oct 20th 2005
From The Economist print edition

Does George Bush want to curb proliferation or court allies? He can't easily do both

Get article background

NO MORE fazed by charges of cronyism abroad than he has been at home, George Bush makes no bones about dividing the world into friend and foe. Nor has he ever had much patience for rules that, as he sees it, don't serve America's best interests. Yet there is one document the administration has repeatedly waved under the nose of other governments, including North Korea's and Iran's: the Nuclear Non-Proliferation Treaty (NPT).

The problem for Mr Bush is that his desire to curb the spread of nasty weapons is starting to clash with his desire to reward friends. The current battle has to do with India, a famous rebel against the NPT, which built its nuclear bomb behind Bill Clinton's back; but it raises questions about Mr Bush's diplomacy in general. The administration is right to point out that rules-based organisations can be very frustrating, especially if you end up with Iran on the board of the International Atomic Energy Agency. But breaking those rules can lead to anarchy.

When India's prime minister, Manmohan Singh, visited the White House in July, Mr Bush delighted his guest and startled some of America's closest allies by offering to overturn decades of American law, as well as the rules of the 45-nation Nuclear Suppliers Group, to allow full civil nuclear co-operation with India. The Atomic Energy Act and the Nuclear Non-Proliferation Act forbid co-operation with countries that do not put all their nuclear industry under international safeguards or that have exploded a nuclear device since 1978. India fails on both counts.

The deal was negotiated hastily and in secret by a clutch of senior administration officials. This week one of them, Nicholas Burns, a senior State Department man, said he expected an

agreement with India on the clearer separation of its civilian nuclear activities from its military ones, as well as new American legislation to exempt India from the existing anti-nuclear rules, to be in place by the time Mr Bush pays a return visit to India in early 2006.

Now Congress will have its say. The House International Relations Committee will hold hearings on October 26th, and the Senate Foreign Relations Committee on November 3rd. The administration probably calculates that, though Congress may grumble at letting India off the hook so comprehensively, it will do little.

Indeed, why not help India? It is a potential ally whose neighbours include prickly Pakistan and China, America's competitor for influence throughout Asia. America has long wanted to tie India (like its fellow non-NPT rebels, Pakistan and Israel) into some form of non-proliferation regime. That seems even more urgent after the uncovering of the nuclear Wal-Mart run by Abdul Qadeer Khan, once Pakistan's chief weapons scientist. And India could also be a lucrative market for America's nuclear industry, which wants to get in ahead of Britain, France and Canada.

On the other hand, favours done for friends can create more problems than they solve. In this case there are serious problems with both the India deal itself, and the precedents it sets.

Begin with the India deal. India is insisting that it wants to be treated just like one of the official five nuclear powers (America, Russia, Britain, France and China). Mr Bush backed off recognising it as such. But it will still be up to India to decide which of its nuclear installations should go on the civilian list, to be inspected. Mr Burns, heading for Delhi this week, will encourage India to make the list as long as possible. But the close connection between India's civil and weapons industries will surely limit it.

Robert Joseph, State's senior official for arms control, told a House committee last month that America would do nothing to further India's nuclear-weapons programme. But what does that mean? In the talks leading up to the July deal, America had encouraged India to cap voluntarily its production of fissile material—highly-enriched uranium and plutonium for bombs—as the official nuclear five have done. Yet it refused and the administration went ahead with the deal anyway.

If that implies that India outnegotiated America, it certainly looks that way. Without a cap on fissile material, argues Henry Sokolski of the Washington, DC-based Non-Proliferation Education Centre (NPEC), co-operation with India will help it devote more scarce resources and materials to its weapons. The administration, he argues, has missed a chance to rein in India's growing arsenal (thought to consist of up to 50 assembled warheads now, but with plans for some 300-400 by early in the next decade).

Some critics go further, suggesting that the administration wants to encourage India's weapons build-up precisely to counter China's growing arsenal. But provoking an arms race with either China or Pakistan (which watches India's every move with deep suspicion, and vice versa) would only worsen endemic instability in the region. In any case, suggests George Perkovich of the Carnegie Endowment for International Peace, a think-tank, India's importance should not be subordinated to a strategy of containing China.

America also proposes to assist India's space programme. Nothing wrong in that, you might say, but plans for India's first inter-continental ballistic missile depend heavily on the technology developed for its space-launch vehicle. Nor does India need an ICBM to deter China, points out Richard Speier in a draft report for NPEC. An upgraded version of its *Agni* missile could deal with that threat. Indian officials have previously said the bigger missile's presumed targets would be in Europe and the United States.

Then there are the broader implications. Bending the rules for India makes it harder to uphold

them elsewhere. Why not also bend them for Pakistan and Israel? Because, unlike India, their energy needs do not depend as much on nuclear power, was Mr Joseph's rather lame explanation.

That will evoke knowing smiles from Iran and North Korea, both of whom have been found secretly dabbling with plutonium and enriched uranium. Iran claims its nuclear activities are simply to keep the lights on. North Korea insists it has built the bomb already, but now wants America to provide it with a modern light-water reactor as the price for disarming. Congress would be apoplectic if the administration agreed, though that is just the sort of reactor India might like too.

In the past America has leaned hard on South Korea and Taiwan to abandon nascent nuclear ambitions. Brazil and Argentina likewise agreed to give up their military efforts and join the NPT; so did South Africa, Ukraine and Kazakhstan. Japan is also a “responsible state with advanced nuclear technology”, as America now calls India, but has kept to the NPT rules.

It gets worse. Mr Bush has called for a moratorium on the sale of uranium technologies to countries without them, but he has winked at Brazil's decision to build a uranium-enrichment plant. Before 2000, America encouraged Argentina to export nuclear research reactors to Peru, Egypt, Algeria and Australia. Now Venezuela, whose president, Hugo Chávez, is no friend of Mr Bush, says he wants one too. Brazil is unlikely to help, but Argentina might be tempted by the cash.

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The Plame scandal

Santa is on his way

Oct 20th 2005 | WASHINGTON, DC
From The Economist print edition

Washington is obsessed by what one prosecutor will do

READERS of the *Daily Kos*, a left-wing blog, are so excited about the fact that Patrick Fitzgerald is about to wrap up his two-year inquiry into the Bush administration's alleged outing of a CIA agent, Valerie Plame, that they are swapping tips on how to keep calm. Give up the coffee; resist the urge to check the *Drudge Report* every minute; and when what they call “Fitzmas” finally comes, enjoy the moment. Take a deep breath and witness a great wrong being righted.

This week the internet has been buzzing with rumours that Mr Fitzgerald is about to indict Karl Rove, Mr Bush's closest adviser, Lewis “Scooter” Libby, Dick Cheney's chief of staff, and, most sensationally of all, Mr Cheney himself. But rumour is the important word: nobody in the journalistic world, let alone the blogosphere, really knows what Mr Fitzgerald, who has run his investigation with tight-lipped professionalism, will actually do.

With that caveat, it seems reasonable to say three things about the current state of affairs. First, it looks increasingly unlikely that the federal prosecutor will return to Chicago without any indictments. He interrogated Mr Rove for over four hours on October 14th, hardly a good sign. (Mr Rove has also cancelled three public meetings with conservative groups.) Two days later Judith Miller, a reporter who originally went to jail for not revealing her contacts with Mr Libby, gave a lengthy account of her ordeal in the *New York Times* where she said she was repeatedly asked about receiving classified information from Mr Libby. The Associated Press claims that Mr Rove and Mr Libby have admitted discussing their contacts with reporters before Ms Plame's name appeared.

Second, Mr Fitzgerald seems to be putting the vice-president's office at the centre of his investigation. Murray Waas, writing on the *National Journal* website, claims that the prosecutors are zeroing in on contradictions between statements made by Mr Libby and Ms Miller; they are also scrutinising whether Mr Libby, or his lawyer, tried to discourage Ms Miller from testifying to the grand jury or tried to influence what she said. They appear to have different memories of a two-hour breakfast meeting in Washington, DC, on July 8th 2003: Mr Libby allegedly claims that he didn't know that Ms Plame worked for the CIA at the time, but Ms Miller has handed over notebooks that supposedly reinforce her claim that he told her that.

This focus on the vice-president's office is hardly surprising. Ms Plame was allegedly outed as part of an effort to discredit her husband, Joe Wilson. (He had been sent to Niger by the CIA to check whether Saddam Hussein was buying uranium there; and he had accused Mr Bush of lying about that. The spin-doctors, perhaps unaware of Ms Plame's covert status, were allegedly trying to claim Mr Wilson had got the Niger job only because of his wife's influence.) Mr Cheney headed the main pro-war faction in the administration, which was most angry with the CIA.

Third, Ms Miller's reputation and that of the *New York Times* have been hurt by the Plame affair. You might have thought that Ms Miller would be a journalistic hero, having gone to prison for 85 days to defend the principle that you don't betray a confidential source. But things are more

complicated, especially after her somewhat opaque article in the *Times*.

Some anti-war leftists are still furious about Ms Miller's pre-war reporting about Iraq's rather-hard-to-find WMD. Others question her claim that she went to prison to defend a principle; after all, Mr Libby claims that he released her from any obligation to keep quiet. Her claim that she can't remember who else may have told her about Ms Plame has strained her critics' credulity. Asked what she regretted about the *Times*'s handling of the Miller affair, Jill Abramson, the paper's managing editor, replied “the entire thing”.

The Bush administration might use the same phrase when it comes to the campaign against Mr Wilson and his wife. The affair has stymied the White House for months; now that Father Fitzmas looks about to squeeze himself down the chimney, they are even more worried.

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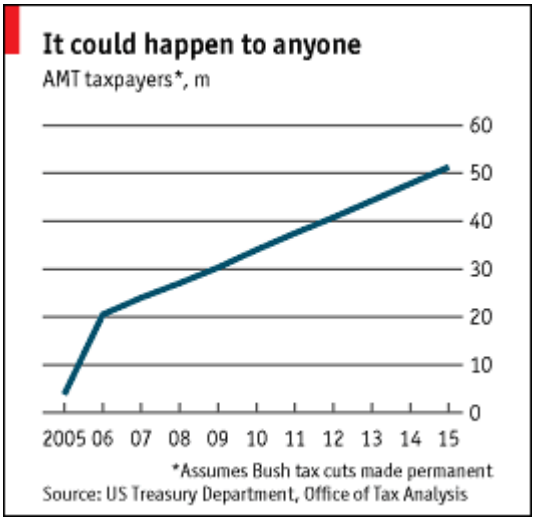
Tax reform

Too sensible to survive

Oct 20th 2005 | WASHINGTON, DC
From The Economist print edition

The tax-reform panel has some good ideas. Too bad they won't happen soon

Get article background



TAX reform is one of the few trump cards with which George Bush could still placate jaundiced conservatives. Many on the right loathe the tax system with fanatical fervour. Along with privatising Social Security, tearing up the tax code has been the main conservative economic priority. With pensions reform going nowhere, tax reform is the one base-rallying idea that Mr Bush has left to push.

But even that is looking tricky judging by the proposals that Mr Bush's advisory panel on tax reform have come up with. This bipartisan panel, set up by Mr Bush after the 2004 election, was told to find ways to make the tax code simpler and friendlier to saving and investment. Its report is formally released on November 1st, but the broad ideas are already clear.

The panel has eschewed the most controversial conservative ideas, such as replacing the income tax with a national sales tax or a single-rate flat tax. Instead it has come up with two alternatives. The more radical one is to switch to a progressive consumption tax with some taxation of investment income added on. The second idea is to keep a streamlined version of the existing income tax with far fewer deductions and lower tax rates.

Both proposals are designed to raise the same amount of money as today's system and leave the distribution of the tax burden largely unchanged. Neither panders to ideology nor flinches from taking on politically popular tax breaks.

The panel's most intriguing idea is the consumption/income tax hybrid. Based on the “X-tax”, an idea first proposed by David Bradford, a Princeton University economist who died earlier this year, it starts by taxing consumption. Businesses, who pay a single 32% tax rate, can deduct all investment spending (but not interest expenses). Wage income is taxed progressively at the individual level, with a top rate of individual tax of 35%.

In the original X-tax, there was no taxation of financial income (dividends, capital gains and interest income) at the individual level, and hence no double taxation of saving. But several in Mr Bush's tax panel, particularly its vice-chairman, John Breaux, a former Democratic senator from Louisiana, worried that this seemed unfair. Individuals who lived off investment income would pay no tax (although that income would have been taxed once already at the corporate level). To increase the plan's progressivity the panel added a 15% tax on financial income, though it allows three sorts of tax-free savings accounts. That twist will bring in some Democrats but appal

conservatives.

Nor is the panel's second proposal likely to find many friends. This approach keeps the income-tax system but scrubs it clean. The number of tax brackets is reduced from six to four (15%, 25%, 30%, 33%), the adjustments for family size are simplified, the myriad incentives for saving are expanded and consolidated into the same three saving accounts as the first option. Business taxes are simplified and lowered.

The biggest single change would be the elimination of the Alternative Minimum Tax, a parallel version of the income tax that was introduced in 1969 to ensure that rich Americans could not avoid paying tax altogether by taking too many deductions. Currently just under 4m richer Americans pay the AMT; that figure will soar to about 20m in 2006 and more than 30m by 2010. To prevent the AMT hitting the broad middle class, Congress has been passing short-term fixes. The tax-reform panel wants the whole thing abolished—at a cost of $1.2 trillion over the next ten years.

To recoup that lost revenue, the panel goes after some of America's most sacrosanct tax breaks. It suggests eliminating the deduction for state and local taxes, capping the tax break available for health-care spending to $11,000 per family; and reducing the tax-subsidy for housing. At the moment, taxpayers can deduct up to $1m of mortgage-interest payments from their taxable income. Under the tax panel's plan, that deduction would be converted into a flat-rate credit of 15%; and the amount of mortgage interest that could be deducted would be between $172,000 and $312,000. The change would be gradual to avoid a crash in the housing market.

Most economists agree that America's tax code would be better off as a result. The tax breaks for health insurance reduce both employers' and workers' incentives to shop around for cheaper health care. The vast tax subsidies for housing encourage over-investment in property rather than other, more productive, assets.

Politically, things are tougher. Tax-reforming conservatives are happy to get rid of the AMT, but they hate the idea of losing mortgage-interest relief, which seems akin to a tax hike. Nor do they like anything that helps people in high-tax states (which tend to be Democratic “blue” states) at the expense of home-owners in red states.

The truth is that revenue-neutral tax reform creates winners as well as losers. It is hard to see a weakened president pushing such political dynamite through Congress. Indeed, tax reform will not happen until politicians decide the current system is unsustainable. But given the rising number of Americans paying the AMT, that day will dawn. When it does, the ideas of this tax panel will be a good place to start.

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Murder, baseball and Chicago

They had it coming

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From The Economist print edition

A city surprisingly at peace with itself

Reuters

Back on track

THE people of Chicago have much to be excited about this month. The White Sox, one of the city's baseball teams (often overshadowed by the still more hapless Chicago Cubs), have earned a berth in the World Series. Meanwhile—and perhaps for unrelated reasons—Chicagoans are getting less keen on killing each other.

In fact they are avoiding this traditional pastime so dramatically that Chicago is having an effect on the national federal crime statistics. The new figures, released this week, show there were 151 fewer homicides in Chicago in 2004—a drop of 25%. That compares with 391 fewer murders in the whole country (a national drop of 2%).

What has happened to Al Capone's kinda town? The local police claim credit for a more active approach to gang violence. More than 40% of the city's murders are officially classified as gang-related, but police reckon the real figure is probably 65%. In the spring of 2003, spurred on by some fairly grisly shootings of young children, the police department focused its resources on “preventing gang killings rather than responding to them”.

The new measures included: installing cameras in the worst areas; mapping out gang territories; assigning officers to collect information from prison snitches (gang leaders often continue to run their businesses from behind bars); keeping track of parolees; and, most important, co-ordinating all available gang intelligence to anticipate where trouble was likely to happen, such as retaliatory shootings. The police have also seized 10,000 or more guns off the streets every year for ten years in a row. As a result of all these things, gang-related homicides fell by a third last year.

The Chicago White Sox last appeared in the World Series in 1959. They lost. The appearance before that, in 1919, was more embarrassing: a group of players took bribes to throw the game. Even if Chicago's baseball excitement proves ephemeral, one hopes the murder progress is permanent.

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Latinos and Republicans

Evidence for the defence

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From The Economist print edition

Reasons why Republicans should be wary of immigrant-bashing

Get article background

SPEND time listening to conservative talk radio, and the constant ranting about immigration—"Fix our broken borders, no amnesty for illegals"—might lead you to the conclusion that George Bush has no hope of ever persuading his party's base to support any plan to "legalise" America's 11m or so illegal immigrants. But you would be wrong.

According to a poll of 800 "likely" Republican voters released this week by the Manhattan Institute, the majority "believe in sensible, practical immigration reform that includes an earned legalisation process and increased border security." The voters think there are too many immigrants, but they reject the anti-legalisation hard line of the Republican congressional leadership; and they actually seem to prefer setting the illegals on the path to full citizenship (see table).

Right to entry
Poll of likely Republican voters, %

Should the number of legal immigrants be:	
Kept at current level	33
Increased	7
Decreased	36
Stopped	16

Would you favour a programme giving illegal immigrants:	Yes
Legal status with possibility of citizenship*	77
Legal status with no possibility of citizenship	24

*Through actions such as working, paying taxes and learning English
Source: Manhattan Institute

That should give heart to President Bush and his allies on the issue, notably John McCain. However, it sits oddly with this week's blast from Michael Chertoff, the director of homeland security. He told the Senate that his policy goal "is to return every single illegal entrant, no exceptions." He promised to show progress "in less than a year".

The rank-and-file are showing more common sense than Mr Chertoff. It would be an economic nightmare to round up and deport all America's undocumented residents. The idea also shows little understanding of how immigration works.

As a recent report from the Pew Hispanic Centre points out, immigration—legal and illegal—is a tide that moves with the changing health of the American economy. In the first half of the 1990s, for example, the incoming flow of migrants averaged just over 1.1m a year; in the dotcom boom of the later 1990s, it rose to 1.5m a year; after the boom ended, it dropped to around 1.1m in 2002, though it has since risen to around 1.2m. The correlation is particularly noticeable with Mexican immigrants, who account for roughly a third of the overall total. In 2000, when the American economy was at its peak, some 530,000 Mexicans made the trip north; in 2002, when the American economy lost 415,000 jobs, the number of Mexican immigrants fell to 378,000.

The tide, however, never actually turns. Even in the direst times, more people come to America than leave it. In 1970, the foreign-born population of the nation was a modest 9.6m; by the 2000 census it had soared to 31.1m. Perhaps the clearest evidence of America's dysfunctional

immigration system is the fact that illegal immigrants now outnumber legal ones.

Most Americans seem to think the answer is a combination of stick and carrot. Some 72% of the conservatives in the Manhattan Institute sample favoured a reform plan that would increase border security and penalise employers who hire illegal workers but would also allow illegal immigrants, on payment of a fine, to get both worker permits and the possibility of eventual citizenship. Fewer than one in five were so fixated on the stick that they would be less likely to support a politician who backed such a reform plan.

Another reason to make senior Republicans wary of immigrant-bashing is the growing prosperity of America's 41m Latinos. A new study of the Hispanic economy by Goldman Sachs points to the many advantages for companies in pursuing a young and increasingly prosperous slice of the populations: for instance, Latinos will account for a third of America's new housing in the next quarter-century. Businesses, argue the bankers, would be foolish to ignore this market. So, presumably, would political parties.

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Land wars in the west

The greens bite back

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From The Economist print edition

Who owns the beauty of Oregon?

IN 1988, David Adams bought two acres of wooded land in hilly country south of Portland. One of the appeals of the property was Oregon's strict land-use laws, which would protect the area's rural character. But last November Oregonians overwhelmingly approved a ballot initiative toppling those rules. In particular, Measure 37 gave many landowners barred from turning rural land into houses the right to say to the local authorities: let me develop my property, or pay me for the lost value.

Measure 37 was one of the biggest triumphs yet for the western property-rights movement. Ever since it set rules limiting sprawl in 1973, Oregon has been a leader in land-use planning. Its guidelines have encouraged more compact cities and protected farmland and forests, but their inflexibility has stirred resentment. Measure 37 gave people who owned land before 1973 the right to ask officials to waive the rules or pay up; since the measure passed, 2,500 people have done just that.

Now the story has taken another twist. On October 14th, a circuit-court judge in Marion County ruled that Measure 37 violated the state constitution because it created two classes of citizens: people who owned land before the regulations went into effect, and those like Mr Adams who purchased it afterwards. Now the greens are overjoyed, and conservatives furious.

The kerfuffle in Oregon shows how complicated the debate about property rights has become. Strict land-use laws have certainly harmed some local landowners; but others have bought land precisely because they thought their surroundings would stay rural. Mr Adams, a plaintiff in the lawsuit that overturned Measure 37, worries that new homes would disrupt his water supplies. Other plaintiffs were farmers who feared that new housing tracts would lead to complaints from neighbours annoyed by the fact that agriculture is smelly and noisy.

What about the notion that Oregon's beauty, much of it preserved even as the state population has grown from 2.2m in 1973 to 3.6m today, has a value for everybody in the state? “People come here because they're attracted by the quality of the environment,” says Arnold Cogan, a Portland lawyer who helped write the first laws in 1973. Fine, replies Dave Hunnicutt, president of the group that placed Measure 37 on last November's ballot, but that common good has a price for some: “If (rural land) is a public benefit, then the public ought to pay for it,” he says. “That's all Measure 37 was designed to do.”

Oregonians seem puzzled about what to do next. Measure 37 won 61% of the vote last year, but polls since then have shown that an equal number favour effective land-use controls. It is not clear how sweeping the decision overturning Measure 37 will be. Technically, it applies to only three counties, but it will now surely go to the state Supreme Court—and any ruling there would affect the whole state.

Earlier this year the state legislature set up a ten-member commission to review land-use laws.

This “Big Look” commission will now try to craft a proposal that can mollify Measure 37's backers while giving the state some say in development. “We ought to be able to do that,” says Mr Cogan. “We should let a little old lady who has owned property for decades sell some of it off. But that's not the same as letting someone with 300 acres of farmland put in 500 houses. That's just greed.” Mr Hunnicutt's group, meanwhile, are considering drafting new ballot measures.

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Kickball

Up off the couch

Oct 20th 2005 | LITTLE ROCK
From The Economist print edition

At last: a sport for American beer drinkers

ON ANY Sunday afternoon you can expect to see a squad of Zombies, dressed in spray-painted white button-downs with fake blood dripping on their arms, an oversized inflatable fish as a mascot and, in the background, plenty of beer. Like the Eco-Savants, the Loaded Bases and the Betty Ford All Stars, the Zombies are an Arkansas kickball team.

Kickball, a playground game created in the Czech Republic in 1922, might be described as a mixture between baseball and soccer. Players kick a big soft ball and run between bases. It is quickly becoming the team sport of choice for what might be called “mature athletes” in cities in the South and mid-west.

AP

Next stop, Yankee Stadium

The Little Rock Kickball Association was founded by Larry Betz, a former bartender, in 2004. Mr Betz, who now calls himself “the Grand Poobah of All Things Kickball”, managed to pull in 16 teams for his first spring season. In the current autumn season, 51 teams—nearly 1,000 players—have signed up to play.

Officially there is a competitive league and a more laid-back version. In both, players are often seen drinking beer and smoking cigarettes while on the field. But it does have a competitive edge—personified by the Killer B's, a ferocious group who had won every game they had played in the past two years until they were humbled by the Superfriends earlier this month. For both the athletic and less athletic visits to physical therapists are common, with one frequent complaint being a strained quadriceps muscle in one's kicking leg and a nasty bruise on the inner thigh.

Mr Betz believes that kickball offers a lot of “non-jocks” the chance to be a part of a team; many players never participated in sports in high school. In many ways, kickball's main competitors are social clubs such as the Rotary and the Kiwanis; like them, the league spends a lot of time raising money for charity.

The Little Rock Kickball Association is part of a loose Kickball Rebel Alliance, which includes teams from other cities, including Washington, DC, and St Louis. The going rate to play is $200 per team. There is a more stringent outfit: the World Adult Kickball Association (WAKA), which started seven years ago, and now claims 22,830 players stretching across 1,030 teams and 118 divisions in 20 states. It holds its world championship in Washington, DC, next month and is busy building up leagues overseas (including one set up by marines in Iraq).

WAKA calls kickball “the new American pastime” (the motto is trademarked), charges each player

$65 to join and doesn't allow alcohol on the field of play. In Little Rock, where kickball is a child's game for partially-fit grown-ups, this all seems dangerously professional. A sport that started making money or banning beer on the pitch would be dangerously like all the other games kickballers were no good at at school.

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Lexington

Et tu, Brute?

Oct 20th 2005
From The Economist print edition

The waning of the imperial presidency

Get article background

THIS autumn's most gripping television series, HBO's “Rome”, tells the story, in deliciously graphic detail, of how Julius Caesar tightened his grip on power in the capital of the world's greatest empire. In the new Rome, on the banks of the Potomac, exactly the opposite is happening: George Bush's iron grip on power is loosening, as more and more Washingtonians join the revolt against the imperial presidency.

Mr Bush has turned himself into the most powerful president since Richard Nixon, whose “Imperial Presidency” was anatomised by Arthur Schlesinger in 1973. Mr Bush and his consuls came into office determined to restore the prerogatives of the chief executive (Dick Cheney and Donald Rumsfeld were particularly zealous, having served in Gerald Ford's post-Nixon, tethered presidency). Even before September 11th 2001, they took every opportunity to concentrate power in the executive branch, but after the terrorist attacks Mr Bush's advisers seized on the crisis to restore the imperial presidency to its full purple—so much so that Chuck Hagel, a Republican senator, complained that they treated Congress as a mere “appendage”.

They declared and conducted the wars in Afghanistan and Iraq with little congressional oversight. They extended the executive branch's powers of surveillance and prosecution through the USA Patriot Act. And they insisted that the commander-in-chief had a right to hold “enemy combatants” without due process of law. This penchant for asserting executive privilege extended beyond the “war on terror”. Mr Cheney fought like a tiger to prevent the Government

Accountability Office from obtaining documents from his energy task-force (and eventually won). As Andrew Rudalevige points out in “The New Imperial Presidency”, all presidents have tried to erode the post-Watergate constraints on them; Mr Bush didn't so much erode them as blow them out of existence.

Now, however, Mr Bush is beset by woes on all fronts. Five separate polls this month have put his job approval-rating below 40%. And the emperor's Praetorian Guard is terrified that Patrick Fitzgerald, a special prosecutor, may indict leading members of the administration.

All second-term presidents become lame ducks (though they seldom limp and quack this early). Why has it happened this time? Hurricane Katrina did a fair amount of damage. But the main problem is that two important forces that once propelled Mr Bush upwards are now pulling him down.

One force is the war in Iraq. Mr Bush skilfully used the “war on terror” to expand the president's powers while marginalising his critics (or “hand-wringers and appeasers”, as that brutal centurion Tom DeLay, preferred to call them). By turning the 2002 elections into a referendum on his war presidency, Mr Bush won back the Senate for the Republicans. But a war that first entrenched the imperial presidency is now undermining it.

Public support has been strained by a series of calamities: the failure to discover weapons of mass destruction, the prisoner abuse in Abu Ghraib, the administration's refusal to tell the truth about the strength of the resistance. The squabbles between different bits of the government in the run-up to the war continue to dog the administration: the Plamegate affair increasingly looks like a skirmish in a wider struggle between Dick Cheney's office (which was gung-ho for war) and the “hand-wringers and appeasers” in the CIA.

The other force is the conservative movement. Mr Bush could ride roughshod over the opposition so long as the Republican Congress marched in lock-step with the administration—and so long as the massed conservative ranks in the country were willing to lend him vigorous support. But all that is changing. Both Mr DeLay in the House and Bill Frist in the Senate are weakened by potential scandals. Many of the conservative legions are in open revolt over Mr Bush's nomination of Harriet Miers to the Supreme Court. They have spent years cutting Mr Bush slack, not least over his big-spending ways, on the assumption that he would nominate a heavyweight conservative to the Supreme Court. But his decision to nominate a lightweight palace attendant who may not even be a conservative is forcing a wide-ranging re-evaluation of his presidency on the right.

Beware the ides of March

The waning of the imperial presidency will encourage other branches of government to fight back. Even before Mr Bush's current problems there was resistance. In 2002 Congress bullied the White House into holding an inquiry into September 11th; and the Supreme Court has reined in some of Mr Bush's powers over terrorist suspects. Now resistance is much stronger. On October 5th the Senate, where Brutus McCain grows ever stronger, administered a slap in the administration's face when it voted 90 to 9 to ban the abuse and torture of detainees.

But the most vigorous opposition will come less from Congress (where the Republican majority is still tied to the president) than from the fourth estate. There is a noticeable mood of shame in the Washington press corps: shame that it failed to ask tough questions about weapons of mass destruction; shame that it was not quick enough to dig into the murky world of lobbying; shame that it was used to smear critics of the Iraq war. That shame is congealing into a desire for revenge. The press will be asking a lot more hard questions—and this time it will find eager

sources among disillusioned conservatives.

Mr Ford once complained that America had replaced an “imperial” presidency with an “imperilled” presidency. Mr Bush still has a chance to recover his equilibrium, particularly if he can persuade conservatives that they have more to gain from sticking with him than turning against him. But the chances of history repeating itself are growing by the day.

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Brazil

Protecting citizens from themselves

Oct 20th 2005 | DIADEMA
From The Economist print edition

Reuters

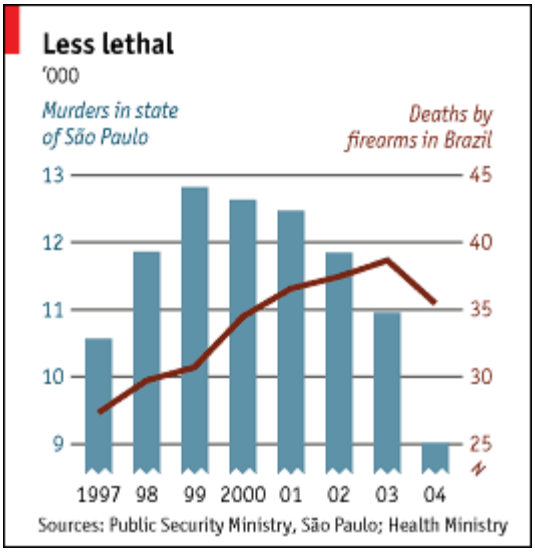
Gun control is saving lives in Brazil. Voters will now decide its pace

IN THE late 1990s the citizens of Diadema were so ashamed of living there that they registered their cars in neighbouring São Paulo, Brazil's biggest city, rather than be seen driving around with local plates. The source of the stigma was crime: in 1999 there were 374 murders in Diadema, a rate of 110 per 100,000 people, staggering even by Brazilian standards. The dense and gritty satellite town became notorious nationally as a “land without law.” Television news showed a video of police who had set up a roadblock to beat and extort money from passing motorists, shooting one dead. Jobs disappeared.

Today, Diadema is transformed. Appalled by the place's reputation, a newly elected city government in 2000 launched a multi-faceted campaign against violence, which by 2004 had cut the murder rate by two-thirds. Business came back. Last year Diadema created more industrial jobs than any other municipality in São Paulo state, boasts its mayor, José de Filippi. It is a spectacular example of a broader turnaround. In São Paulo state the number of murders has plunged, and it has started to fall nationwide (see chart).

That Brazil is becoming a slightly safer place is not apparent from the angry debate surrounding a national referendum on whether to ban the sale of guns and

ammunition, to be held on October 23rd. The anti-gun movement had expected an easy win. But the pro-gun campaign, a coalition of weapons-makers and conservative groups, has turned the referendum into a vote of confidence in the state's capacity to protect its citizens. Defend yourselves, they urge, because the government will not. Polls suggest that Brazilians, whose neighbourhoods have seen more carnage than the battlegrounds of Colombia or Chechnya, may agree.



A “No” vote would be a setback for public safety. Gun control was probably the main reason for last year's drop in the national murder rate and is a big factor in São Paulo's declining rate. But the proposed ban on gun sales is just a small part of a national gun-control effort. It is state—and increasingly municipal—governments that have the biggest role in fighting crime.

Tulio Kahn, head of planning for São Paulo's public-security ministry, unfurls a list of possible explanations for the fall in the state's murder rate, from the growth of protestant churches, which preach against drink and violence, to the near tripling in the prison population since the mid 1990s. Crime mapping began in 1999. Several municipalities, including Diadema, passed “dry laws” shutting down bars early to reduce drunken mayhem.

But the main factor, Mr Kahn thinks, is disarmament. The federal government made illegal possession a felony in 1997. In São Paulo, seizures of guns rose from 30,000 to 40,000 a year. The state government cut the number of gun licences it granted from 70,000 a year to 2,000. The effect was not to disarm criminals but to take guns away from ordinary people who kill on impulse, the commonest sort of murder. Mr Kahn notes that 80% of victims die within a kilometre of their homes, which suggests they knew their killers.

Diadema extended disarmament to toy weapons, whose sale is banned within its city limits. Perhaps more important, it started a municipal police force to patrol neighbourhoods, leaving the two state-run forces to chase criminals and conduct investigations. Bar-closing laws are enforced daily by inspectors who learn which establishments they will be visiting only minutes before heading out. Truant teenagers are herded back into school and offered counselling and training. “Violence has many causes” and demands a mix of prevention, repression and social policy, says Regina Miki, Diadema's “secretary of social defence”. A second security plan calls for mediating neighbour disputes and improving school security.

Local successes, such as that in Diadema, have not changed the national mood. The poor, who bear the brunt of violence, back the ban on gun sales, polls suggest. But many middle-class Brazilians, often robbed at gunpoint but rarely shot, wonder why the government proposes to disarm “honest men” while leaving criminals with their guns.

“By disarming the citizen you're disarming the criminal,” retorts Denis Mizne of *Sou da Paz* (“I am for peace”), an anti-violence group in São Paulo. In Rio de Janeiro, one of Brazil's most dangerous cities, 61% of guns seized from criminals had belonged to ordinary citizens.

Federal police registered 53,000 guns last year, a figure that would fall to close to zero if the referendum passes. That would still leave Brazil with an arsenal of perhaps 17m guns, around half of them unregistered. But even if the referendum fails, they will continue to be subject to a tough 2003 law. This stiffens sentences for carrying a gun illegally, in some cases denying bail to violators. It also requires gun owners to prove that they are sane and know how to use one. Under

its terms, a buyback scheme collected nearly half a million guns last year. Hence the drop in the national murder rate. If the referendum passes, that trend may quicken. If not, it will be up to local governments to create thousands of Diademas.

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Economist.com WORLD LATIN AMERICA

Colombia

Uribe's court win

Oct 20th 2005 | BOGOTÁ
From The Economist print edition

A second term edges closer

Get article background

FOR months, only one question has mattered in Colombian politics. Would the Constitutional Court uphold an amendment to the constitution to allow a president to stand for a second term? On October 19th the court finally said yes. That opens the way for Álvaro Uribe to stand in and—almost certainly—win next May's presidential election. But first he must surmount one last legal hurdle: the court said that it would rule by November 11th on the validity of a reform of the electoral code which fixes rules for the candidacy of an incumbent president.

The court's judgment, though not unexpected, was a big victory for Mr Uribe. His tough security policy, in a country long plagued by violence from left-wing guerrillas, rightist vigilantes and drug-traffickers, has made him wildly popular. Polls suggest that he would win the election outright, with some 55% of the vote.

The justices rejected, firmly but not unanimously, 18 different challenges to the re-election amendment approved by Congress last year. Now they will study challenges to the Law of Electoral Guarantees, intended to ensure that opponents are not disadvantaged. If they throw the law out, Mr Uribe would not be able to stand until 2010. If they require amendments, there might not be time to approve these before the election. But the betting is that they will approve this law too.

It is a paradox of Colombia that the most lawless country of the Americas is also intensely legalistic, with a deep-rooted mistrust of executive power. The court ruling “radically changes Colombian politics”, said César Gaviria, the president from 1990-94 and now the head of the Liberal opposition to Mr Uribe. Mr Gaviria, who insists he will not himself stand next year, is not alone in worrying that incumbents will have unfair access to state resources. But all the opposition candidates said they accepted the court's ruling. Mr Uribe's lieutenants will now concentrate on winning a majority in the new Congress, to be elected in March, halting a recent exodus of the president's former supporters to other parties.

Mr Uribe has been an effective president, beating back the FARC guerrillas, negotiating (on controversial terms) the demobilisation of the vigilantes, and restoring economic confidence. An obsessive micro-manager, he has led from the front. Arguably, Colombia would be better served by the institutionalisation of his policies, rather than the continuation of his rule. Elsewhere in Latin America, second terms have often disappointed. Now Mr Uribe is close to having the chance to try to buck that trend. Most Colombians will be pleased at that prospect.

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Ecuador

Confused in the Andes

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AP

A president jailed, another failed

Get article background

WHATEVER else one can say of Ecuador, there's rarely a dull moment in its politics. Two men currently claim to be the country's president. Neither of them commands much respect. One, Alfredo Palacio, the former vice-president, seized power in a congressional coup in April. Since then, he has squandered much of his initial support and seems uncertain as to where he is heading. The other, Lucio Gutiérrez, the man Dr Palacio ousted, knew exactly where he was going when on October 14th he returned to Ecuador: jail.

Dr Palacio, a cardiologist, promised sweeping social change. But he has quarrelled with Congress, which installed him, and briefly with the World Bank, delaying some of his spending plans. Mr Gutiérrez apparently reckons he can exploit his rival's weakness. He gave up political asylum in Colombia (a status he had earlier enjoyed in Brazil) and went home, he said, to “reclaim power by legal and constitutional means”. Arriving by chartered plane in the coastal city of Manta, he was immediately arrested and slung in jail on charges of trying to subvert the government.

Mr Gutiérrez's lawyers are trying to free him. Even if they succeed, he is unlikely to regain power. His main error was to respond to a threatened impeachment by dissolving the Supreme Court. If he hoped for an outpouring of support from the public or the army, he was deluded. But a new Supreme Court must be installed to try him on the most serious charges he faces, and that is proving a slow process.

Dr Palacio's scheme for a referendum on political reform was rejected by Congress. Now he is pushing a plan for a constituent assembly. But Ecuador's current constitution dates only from 1998. Since then the country has had four presidents. What it lacks is not another political fix, but good government.

Economist.com WORLD LATIN AMERICA

Mexico's presidential race

The third man

Oct 20th 2005 | MEXICO CITY
From The Economist print edition

Calderón changes the calculus

Get article background

“GRADUALLY, and then suddenly.” That was the description by one of Ernest Hemingway's characters of how he went bankrupt. It is also how Santiago Creel, against initial expectations, is losing the presidential nomination of the conservative National Action Party (PAN). Mr Creel was President Vicente Fox's interior minister and heir-apparent. Since Mr Fox's government is widely seen as disappointing, that may not have helped him much. Neither did Mr Creel's own poor campaigning and performance in a debate.

The result: Mr Creel was trounced in two regional primaries by Felipe Calderón, a former energy minister who resigned after clashing with Mr Fox. If Mr Calderón picks up more than 50% or so of the vote in the third on October 23rd, he will become the PAN's candidate; otherwise, he will face Mr Creel in a run-off that he can expect to win.

The advent of Mr Calderón throws extra uncertainty over the outcome of next July's presidential election. Opinion polls had long placed Mr Creel a distant third behind Andrés Manuel López Obrador, the left-wing former mayor of Mexico City, and Roberto Madrazo of the Institutional Revolutionary Party (PRI), which had governed Mexico for 71 years, until Mr Fox came to power in 2000.

Mr Calderón's victory now brings hope to the PAN faithful. He is youngish, at 43, and is a technocrat with a reputation for honesty and a strong party background. He says he hopes to benefit from the achievements of Mr Fox's presidency—economic stability and a fall in poverty—while claiming distance from its poor record in getting promised reforms through a divided Congress.

Two other things might help Mr Calderón. The first is that Mr López Obrador, a populist and former PRI member, divides Mexicans. Businessmen, in particular, are casting around for someone to stop the former mayor. The second thing is that the PRI is in disarray. It will hold a primary on November 13th. Mr Madrazo, the party's former president, faces a strong challenge from Arturo Montiel, the ex-governor of Mexico state. Mud is flying. Documents have surfaced suggesting that Mr Montiel's family embezzled public money. That hurt Mr Montiel. But the suspicion that his rival's campaign dug up the documents hurt Mr Madrazo, who has a history of winning elections in controversial fashion.

Mr Calderón's swift rise has caught the pollsters unawares. One survey suggests he is less disliked than any of the other main contenders. Much can happen before the election. Mr López Obrador is a wily politician and an effective campaigner. If the PRI can heal its primary wounds, it will benefit from its powerful national organisation. Jorge Castañeda, a former foreign minister, might yet get on the ballot as an independent. In 2000, Mr Fox managed to embody the desire of many voters to break with Mexico's old order. If Mr Calderón can rekindle that spirit, he could turn a two-horse

race into a tight, three-way contest.

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Economist.com WORLD LATIN AMERICA

Argentina's congressional election

Wife fight

Oct 20th 2005 | BUENOS AIRES
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The battle to control Peronism

Reuters

Get article background

NÉSTOR KIRCHNER was a provincial governor with little national clout when Eduardo Duhalde offered to back his presidential candidacy in an election in April 2003. Mr Duhalde, the incumbent president, had been turned down by three other potential nominees from the ranks of Peronism, Argentina's hegemonic political movement. His formidable machine helped win Mr Kirchner 22% of the vote. That gave him victory by default after Carlos Menem, another former president, withdrew from a run-off ballot. Since then, local pundits agree, Mr Kirchner has been obsessed with his lack of a personal mandate and with his dependence on Mr Duhalde's loyalists among the Peronist majorities in Congress. Together they have given him "an intolerable sensation of political claustrophobia," as *La Nación*, a Buenos Aires newspaper, puts it.

A mid-term election on October 23rd for almost half the 257 seats in the lower house of Congress and a third of the 72-member Senate is Mr Kirchner's first chance to change that. The election sees the president confronting his political maker—through the medium of their wives. The two women are standing against each other for the Senate in the province of Buenos Aires, home to 40% of Argentines and long Mr Duhalde's political bailiwick. Cristina Fernández de Kirchner (pictured), who is currently the senator for the couple's Patagonian home province of Santa Cruz, leads the polls with around 38%. Her rival, Hilda González de Duhalde, has around 16%, and seems assured of a Senate seat as the runner-up.

Mr Kirchner is popular, thanks to a strong economic recovery and a nationalist stance that has soothed a country which felt humiliated by the financial collapse of 2001-02. But only a crushing victory in the province will achieve his goal of dominating Peronism. Anything less, and he risks emerging weaker than before his public split with Mr Duhalde in July. On current trends, only around 70 unconditional supporters of the president are likely to win seats in the lower house, and perhaps 30 followers of Mr Duhalde. If his wife wins big, Mr Kirchner can hope that the momentum will attract to his side some of the Duhalde people as well as Peronists currently aligned with neither man. But if the result in the province is closer than the polls predict, then "the Duhaldes aren't dead," says Sergio Berensztein of Poliarquía, a political consultancy. "They're still there, they count, and they can make the president's life miserable."

The best chances of the meagre opposition to Peronism lie in the federal capital—the wealthy inner core of Buenos Aires. There, the polls predict victory for Mauricio Macri, the conservative president of Argentina's most popular football club, Boca Juniors. Close behind is Elisa Carrió, whose centre-

left party may add another three to its 11 seats in the lower house. Rafael Bielsa, the foreign minister and Mr Kirchner's candidate, trails in third place.

The election may also cast light on the health of Argentina's democracy. On the one hand, Congress may become livelier. The likely election of Mrs Duhalde, Mr Menem (as a senator from his home province of La Rioja), Mr Macri and Ms Carrió means that all of the forces opposing the government—both within Peronism and outside it—will have weighty representatives. The campaign has also shown that Peronism remains addicted to patronage politics. Mr Kirchner has flooded Buenos Aires with federal largesse. In reply, Mr Duhalde has tried to cash in political favours owed from a lifetime as a party boss. Largely absent have been issues of policy. Despite the president's vows to bring a new politics to Argentina, he has chosen to test himself by how well he has mastered the old version.

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Economist.com WORLD ASIA

Controlling pollution

The greening of China

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From The Economist print edition

Eyepress

China is investigating whether its rigid system for assessing the performance of party leaders and civil servants can be used to tackle pollution

AN ELABORATE points system that determines the careers of officials is often blamed for many of China's problems. In their drive to meet targets for economic growth, local mandarins squander money, ride roughshod over citizens and ravish the environment. So now China is trying to devise and embed into its assessment of officials a way of calculating a “green GDP”—which allows for environmental costs in national accounts—to help mitigate some of these excesses.

President Hu Jintao first endorsed the idea in March 2004, in a speech about the need to foster a “scientific concept of development”, a slogan intended to suggest that in pursuing growth China should pay more heed to such issues as the environment and the depletion of natural resources. Last February, the government said that ten regions, including Beijing, were carrying out a pilot project in green GDP assessment. Pan Yue, the deputy director of the State Environmental Protection Administration, said a “framework” for a green GDP accounting system could be unfolded within three to five years. This would make China the pioneer of a statistical approach that no other country has adopted—and which many economists around the world eschew as an attempt to quantify the unquantifiable.

So why bother? Mr Pan, a media-friendly 45-year-old with a reputation for talking tough on polluters, has highlighted the problem of how China evaluates the performance of local leaders. This has evolved in the last two decades into a system of fiendish complexity. In the days of Mao Zedong, loyalty to the Communist Party was pretty well all that counted. Nowadays, adhering to the party line is only one important test. Points are awarded for an array of targets, and the promotion and bonus prospects of an official who scores below par will suffer.

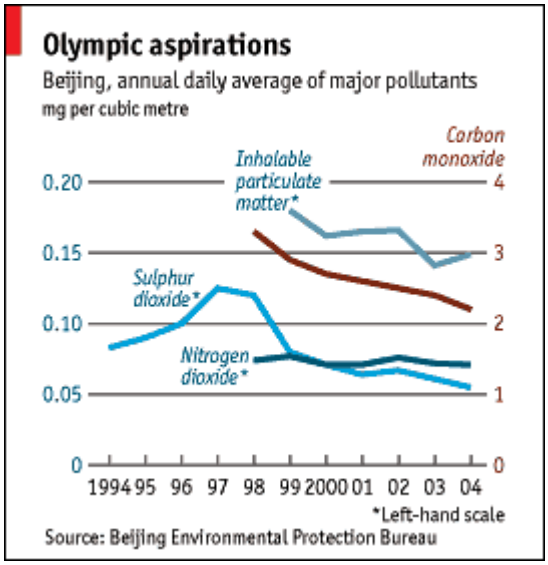
Targets are usually set by the next-highest level of the party (for party leaders) or government

(for government officials). To minimise the need for subjective judgments, they are often very precise. A leader is told that his area must achieve a certain rate of GDP growth, attract a certain sum of inward investment and increase government revenues by a specified amount. Some of these are designated as “veto” targets: failing to meet them will ensure that the cadre is rated as underperforming, even if he scores well in other areas. GDP growth, population control and social order are often among the veto categories.

In an autocracy, officials often feel at liberty to pursue these targets at any cost. This is why, in order to limit births or prevent public protests, officialdom is guilty of widespread abuses of human rights. The same system causes colossal waste and environmental damage as officials doggedly pursue growth targets. China is littered with extravagant and often useless building projects with no purpose except to impress superiors. One egregious example is a vast $40m airport completed in 1998 in the remote city of Fuyang in Anhui province. It has been closed for several months because it was hardly used. Of China's 660 or so cities, no fewer than 183 have vowed to turn themselves into “modern international metropolises”.

Mr Pan says that devising a green GDP target would help to focus official minds on the price of reckless development. Such a figure would be calculated by subtracting the cost of the natural resources used and the pollution caused from regular GDP. If only it were that simple. From calculating the market value of the extinction of a species, to the cost of soil erosion resulting from the felling of trees, to the health damage from pollution, the exercise is riddled with complexity. China's normal GDP figures are often suspect enough, particularly those produced by local governments, without adding a whole new layer of numbers even more prone to manipulation and dispute.

The lack of an agreed method has not deterred some experts from coming up with green figures. Niu Wenyuan, a government adviser and professor at the Chinese Academy of Sciences, says that the country's annual average GDP growth from 1980 to 2000 of 9.6% should be really be 6.8% if reckoned greenly. This difference, he says, would not be out of line with other fast-growing countries. Academics in the northern province of Shanxi, a centre of coal production, have calculated that environmental costs and natural-resource losses amounted to 33.4% of its GDP in 2002.



However, the National Bureau of Statistics, which is running the pilot programmes jointly with the environmental-protection agency, is less enthusiastic about the project. In Anhui province, one of the pilot regions, the team responsible for devising a way to calculate green GDP consists mainly of environmentalists rather than economists. Some people say the scheme is a ploy by the environment agency to draw political attention to China's pollution problem, but one that is unlikely to produce practical results.

Even without a green GDP system, there is nothing to stop governments introducing green criteria into the way they rate the performance of officials. A few have done so already. Beijing's leaders have promised stringent targets for pollution control for the 2008 Olympic Games. With huge central-government assistance—which other governments cannot count on—the city has succeeded in reducing its air pollution (see chart). But a recent upsurge of private car ownership is undermining these efforts; note the rise last year in inhalable particulate matter, average levels of which remain triple those of American and Chinese national standards.

China's top leaders themselves may be getting cold feet. A draft of the national economic-development plan for the next five years, published this week, stresses the need for an “a resources-saving and environment-friendly society”. But it makes no mention of a green GDP.

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Economist.com WORLD ASIA

China and America

Chummy with Rummy

Oct 20th 2005 | BEIJING
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Up to a point

AFP

Not yet eye-to-eye

Get article background

THEY regard him as a warmonger who is determined to portray peace-loving China as a threat. But this week Chinese officials have been treating Donald Rumsfeld with unusual cordiality on his first visit to their country as America's defence secretary. They even let him see their nuclear-missile command centre and address Communist Party cadres about the need for more transparency. But military ties between the two countries are not about to blossom.

The Chinese have long angled for a visit by Mr Rumsfeld, hoping that this would symbolise America's willingness to put aside the fracas that broke out between them in April 2001 when a reckless Chinese fighter bumped into an American reconnaissance plane, forcing it to make an emergency landing in China. The Chinese held the crew for 11 days and kept the aircraft for another three months. Top-level contacts between the Pentagon and China did not resume until 2003.

Mr Rumsfeld's trip to the headquarters of the 2nd Artillery, which commands China's nuclear and conventional missile forces, was a way of placating a defence secretary who has been telling the Chinese to become more open. But his hosts did not let him see the secret nerve centre of the Chinese armed forces, in the hills west of Beijing.

The American seemed unimpressed. Mr Rumsfeld made his misgivings clear in a speech at the Central Party School where mid-ranking cadres are groomed for leadership. Every society, he said, had to be “vigilant against another type of Great Wall” that limits speech, information or choices. And he claimed that other countries wondered why China was rapidly building up its armed forces without acknowledging it: “It raises some questions about whether China will make the right choices.”

In their first “white paper” on democracy-building, issued during Mr Rumsfeld's visit, China's leaders made it clear that they had no plans for significant political reform. The document did not even mention a suggestion last month by the prime minister, Wen Jiabao, that elections to leadership positions in townships could be possible within a few years. It was announced this week that George Bush will visit Beijing on November 19th, for the first time since a new generation of Chinese leaders began taking over in 2002. But he will find the new lot as Leninist as the last.

Economist.com WORLD ASIA

Japan

Koizumi's next steps

Oct 20th 2005 | TOKYO
From The Economist print edition

Now that he's visited the Yasukuni shrine

Get article background

LATE last week, Japan's parliament comfortably passed bills that will eventually lead to the privatisation of the country's post office, a behemoth that not only delivers the mail but is also the world's biggest financial institution, specialising in channelling savings towards politicians' pork-barrel projects. It was the upper house's voting down of the bills in the summer that led the prime minister, Junichiro Koizumi, to go over the head of his Liberal Democratic Party (LDP) and call a snap general election for September 11th. The astounding outcome of that political gamble—a clear popular mandate for privatisation—brought a fractious LDP back into line, redoubling the prime minister's authority both within the government and the country as a whole.

Yet rather than bask in these achievements, Mr Koizumi this week strode towards new controversy, by paying a sudden visit (his fifth as prime minister) to Tokyo's Yasukuni shrine on October 17th. The place is Japan's chief memorial to its war dead. It is also a focal point for right-wing fanatics and their view that Japan was more victim than aggressor in the half-century of Asian wars up till Japan's defeat in 1945. The souls of 14 war criminals are among those enshrined there.

Even though his visit was followed by those of about 200 parliament members, Mr Koizumi immediately played it down. He went, you see, in a private capacity not a public one: did he not wear a plain grey suit instead of the customary morning tails? Though he pledged that Japan would never wage war again, both Chinese and South Korean foreign ministers cancelled planned meetings with their Japanese counterpart, Nobutaka Machimura. The Chinese authorities issued orders to cancel bilateral exchanges on the mainland, citing a desire at a time of fervent anti-Japanese feelings to prevent “unexpected contingencies”. A planned summit later this year between South Korea's Roh Moo-hyun and Mr Koizumi is also off.

Mr Koizumi's visit also displeased some of his domestic allies. No other cabinet members visited the shrine, and some were outspoken in their criticism. Still, the consequence for Mr Koizumi's domestic agenda is likely to be negligible. There, the two issues of pressing interest to the political classes are, first, who is in the running to succeed Mr Koizumi if, as he promises, he steps down as party leader and prime minister next September; and second, now that postal privatisation is in the bag, what, if anything, is Mr Koizumi's reform agenda for the remainder of his term? When those two issues are answered, a third will arise: will the successor wish or be able to run with the reform agenda sketched out by Mr Koizumi?

Part-answers to all these questions may be supplied as soon as November 2nd, when a cabinet reshuffle is expected. Four men are spoken of as possible successors to Mr Koizumi: the favourite, Shinzo Abe, the LDP's acting secretary-general, a vocal Koizumi supporter and scion of a political dynasty; Yasuo Fukuda, an LDP grandee (and son of a former prime minister) who has kept some distance from Mr Koizumi since resigning as chief cabinet secretary last year; Taro Aso, internal-

affairs minister and, like Mr Abe, grandson of a former prime minister; and Sadakazu Tanigaki, the finance minister, whose chief virtue is that he has few enemies. If any of these fail to get a post in the new cabinet, their chances are scotched.

One other person to watch in the reshuffle is Heizo Takenaka. Mr Takenaka, a former academic, was put in charge of first banking reform and then postal privatisation. He has now been instructed to come up with proposals to reform the remaining clutch of government-affiliated banks, to clean up a series of opaque government accounts, and to cut the number of public employees at every level of government. What task Mr Takenaka is allotted, whether it is slimming government or reforming the medical system, for instance, will give a sense of the priorities in what remains of Mr Koizumi's term.

And after that? Mr Koizumi's mantle is attractive enough for his successor to want to inherit it; so his policies are likely to be followed. None of the four candidates for the party leadership appears to have differences over domestic policy. The problem is knowing whether they have any strong views at all.

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Kashmir's earthquake

Aftershocks and afterthoughts

Oct 20th 2005 | DELHI
From The Economist print edition

As the humanitarian disaster worsens, Pakistan makes a U-turn

Get article background

Reuters

Musharraf is also shaken

AFTER last December's devastating tsunami, it was hard to imagine any bigger natural disaster. Yet some aid workers think the earthquake that rocked the disputed territory of Kashmir on October 8th has brought an even more serious humanitarian crisis. Mercifully, not nearly as many people have died. But the numbers without shelter, their inaccessibility, continued aftershocks, and the onset of the long, cold winter make this a calamity that is deepening over time.

Into the second week of the relief effort, the number of confirmed dead kept climbing remorselessly, to 1,300 in Indian Kashmir and well over 40,000 in Pakistan, with a further 65,000 injured. Perhaps 3m are homeless. The United Nations reckons some 500,000 people had still not been reached by rescue teams. The UN's children's agency says they include as many as 120,000 children, of whom 10,000 might die of hunger, hypothermia and disease in the next few weeks. Only half of the needy had received emergency rations.

The outside world, too, was slow to respond. By October 20th, only 12% of a $272m appeal launched by the UN had been raised. There was a desperate shortage of tents capable of withstanding the Kashmiri winter, of blankets, sleeping bags and warm clothes, as well as of medicine and food.

More than 1,000 affected villages can be reached only on foot or by helicopters, which are also in chronically short supply. Pervez Musharraf, Pakistan's president, refused India's offer of army helicopters. The aircraft were welcome, he said, but there were “sensitivities” about allowing Indian soldiers into Pakistan-controlled Kashmir. India, of course, refused to send its helicopters without their crews.

On October 18th, however, came the first sign of hope that the earthquake might, after all, help India and Pakistan edge closer in their long dispute over Kashmir. General Musharraf announced that Pakistan was ready to allow Kashmiris to cross the “line of control” dividing Indian- and Pakistani-controlled areas to help their families. Typically for a man whose diplomacy smacks of his career as a commando, General Musharraf made this offer—laden with symbolic importance—not to Indian officials or leaders, but to reporters at a press conference.

India welcomed it warily. After all, it is Pakistan which has been resisting such “softening” of the line of control, fearing that this would lead to its eventual acceptance as a legitimate international border, an outcome India would love. The next day, India produced its own gift for Kashmir, the temporary opening of phone links to Pakistan, to enable divided families to talk to each other.

India cut the lines in 1990, after the outbreak of a still-simmering insurgency against Indian rule, which has cost perhaps 80,000 lives. Some of the fighters are militants sneaking in from the Pakistani side. The militant groups seem to have taken a heavy hit in the earthquake, with some of their training camps in Pakistani Kashmir destroyed.

An umbrella group claiming to represent the various jihadist groups in Kashmir has announced a ceasefire. But on October 18th, a militant in Srinagar, summer capital of Indian-administered Kashmir, assassinated the state education minister. It seemed a desperate bid to show that the insurgency has survived the earthquake, and still has the power to hurt India, even in its most protected enclaves.

In some villages on the Pakistani side of the border, militant groups have gained prestige, organising relief work long before the arrival of the Pakistani army, whose performance has been widely criticised. That is bad news for its chief, General Musharraf. He has risked unpopularity before, by promising to crack down, at the behest of America and India, on the militants. But the grumbles those promises provoked were trivial compared with the current public anger, as hundreds of thousands of Pakistanis remain at grievous risk, and, fairly or not, the army and the government take the blame.

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Economist.com WORLD ASIA

Afghanistan

Multi-multi-party democracy

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The new parliament is a mixed bag

Get article background

LOW turnout, widespread allegations of fraud, notorious warlords topping the ballots; it is fair to say that Afghans harbour at best dim hopes for their new parliament, elected on September 18th. However, buried among the results, which are now almost complete, are signs of a quiet, though decidedly uneven, revolution.

The eastern province of Nangarhar is perhaps the best example, though at first glance the signs do not seem promising. Topping the ballot there, as in many provinces, is a 24-carat warlord with alleged narcotics links and a dubious human-rights record. Hazrat Ali, the former provincial police chief, polled 2,000 more votes than his nearest rival, thanks to a strong tribal base and lavish campaign spending. The surprise is the failure of the established elite elsewhere in the province. The family of the murdered former vice-president, Haji Qadir, had carved up Nangarhar between them for more than a decade. Yet their supporters were rejected at the ballot box and a group of well-respected figures with good local records were elected instead. In a number of other provinces the grip of the old order was significantly weakened too.

Confounding pre-election predictions that women would win only in special reserved seats, amounting to 25% of the total, third place in Nangarhar went to a female candidate: an Afghan-Canadian returnee working in rural redevelopment. Women candidates won seats in their own right in no fewer than 13 of 34 provinces.

Of course, the picture was uneven across the country. In many provinces local strongmen offering nothing but the promise of patronage or the threat of retribution have triumphed, as have many feudal and spiritual figureheads. But so have a few candidates who put forward comprehensive platforms for change.

In Kabul, Bashar Dost, a former planning minister, came third overall, just behind two ethnic leaders—Yunus Qanuni, a Tajik, and Mohammed Mohaqeq, a leading Hazara. Mr Dost's attacks on the mujahideen—the guerrillas who fought the Russians in the 1980s but since then have more often terrorised Afghanistan—and outspoken criticisms of “corrupt and wasteful” western NGOs played well with voters. He was also one of the few candidates to abandon traditional backroom dealings and talk directly to the electorate. His van chugged round Kabul, speakers blaring, for weeks on end. Malalai Joya, who emerged from obscurity when she denounced the mujahideen as criminals at the 2003 constitutional convention in Kabul, came second overall in Farah Province.

The much-criticised electoral system chosen by the government, the single non-transferable vote, has done what many suspect President Hamid Karzai intended, by returning large numbers of non-aligned candidates at the expense of established political parties. Early results suggest that slightly more than a third of the lower house will support opposition parties, slightly less than a third will be pro-government and a third will be unaligned.

However, some results were simply bizarre. The overall victor in the western city of Herat was an attractive female aerobics instructor named Fauzia Gailani. With no political credentials at all, she beat a heavily bearded, fundamentalist supporter of the ousted local potentate, Ismail Khan, into second place. On the other hand, she had a beguiling campaign poster, so maybe it was not so bizarre. Perhaps politics in Afghanistan can become more ordinary than people imagine.

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Economist.com WORLD ASIA

New Zealand

A beast with several backs

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Helen Clark's creative government-making

Get article background

IS IT possible for a party to join a government and stay in the opposition at the same time? Helen Clark, who was sworn in for a third three-year term as New Zealand's prime minister on October 19th, obviously thinks so. Her minority coalition, of Labour and the one-man Progressive Party, commands only 51 votes in the 121-seat parliament. To give herself a working majority, she has entered into peculiar agreements with two smaller parties. Their leaders will be ministers, but not members of the cabinet. In theory, that will give them a stake in the government's survival, while leaving them free to criticise its performance.

Forming a government in New Zealand is no mean feat. The proportional-election system in place since 1996 has never delivered an outright victory to either main party, Labour or National. But smaller parties are often reluctant to join coalitions, for fear of denting their following at the next election. If they meekly toe the government line, voters tend to forget them. But if they kick and scream to get their policies adopted, voters punish them for pushiness.

In the 1990s, New Zealand First, one of the two parties not quite in the new government, joined National in an unhappy coalition. Their constant squabbling made not just for an unstable regime, but also for a poor electoral showing in 1999. So when Miss Clark formed the next government, she agreed a mechanism whereby Labour and its coalition partners could “agree to disagree” on certain issues. Three years later, she went further, settling for a minority government that smaller parties agreed to prop up from the outside on critical votes in exchange for certain policy concessions.

The latest arrangement is yet another variation on the same theme. Winston Peters, the leader of New Zealand First, will be foreign minister—probably the only one ever anywhere from outside cabinet, while Peter Dunne, of the centrist United Future, will be revenue minister. Their parties will have to vote with the government on matters related to their portfolios, and on motions of confidence, but will be free to rubbish it otherwise. Meanwhile, the Green Party has agreed to abstain on confidence votes, in exchange for being put in charge of two cherished schemes.

As muddled as this set-up sounds, it might prove durable, precisely because it assumes there will be disagreements and makes allowance for them. That does not mean that voters will like it.

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Israel and Palestine

Ever more separate

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From The Economist print edition

AFP

Israel's building activities in the West Bank suggest that its next territorial withdrawal, if there is one, will be unilateral, not part of a peace deal

Get article background

LATE last month, three Israelis who know something of what is on the mind of Ariel Sharon, the prime minister, seemed to say publicly what many others are thinking privately. Since the "disengagement" of settlers and troops from Gaza and part of the northern West Bank this summer, Mr Sharon has maintained that Israel's next territorial withdrawal will be not unilateral, as that one was, but agreed by both sides under the "road map" peace plan, which calls, eventually, for joint talks on creating a Palestinian state. But Eyal Arad, a public-relations adviser to Mr Sharon, Tzachi Hanegbi, one of his ministers, and Aharon Ze'evi-Farkash, the head of military intelligence, were all quoted as suggesting that if peace talks make no progress, Israel might stage another unilateral pullout from some of the West Bank.

Their remarks might have been trial balloons, or merely soap bubbles, but they caused instant fuss. Such a move would anger both Palestinians, who do not want Israel always setting the agenda, and many Israelis, who resent surrendering land without security promises from the Palestinians in return. Mr Sharon was quick to pooh-pooh the "rumours". Mr Arad, for one, says he was misquoted.

But, say various sources, in high-level backroom discussions the subject is coming up time and again. "When I speak to Israelis of virtually all political stripes, they all believe it's the next thing that's going to happen," says Robert Malley, a Washington-based analyst for the International Crisis Group, a peace-making lobby with headquarters in Brussels. There may well be no plan to

do it. Yet events could inexorably lead to it. This week's murders of three Israelis by Palestinian gunmen, and Israel's response, gave a foretaste of how.

The shootings were in two different places on Route 60, the main north-south highway through the West Bank. Views vary as to which militant faction (or factions) really did it, but they may have been timed to embarrass Mahmoud Abbas, the Palestinian president, who was drumming up support on a foreign tour due to end this week in Washington. Palestinian vehicles, which bear different-coloured licence plates from Israeli ones, are subject to ever-changing restrictions on which roads they may use. Since the start of the Palestinians' second *intifada* (uprising) five years ago some of the main West Bank highways, as well as the by-pass roads that Israel has built over the years to connect its West Bank settlements to one another and to Israel proper, have become Israeli-only. Some, among them Route 60, are usually open to at least some Palestinian vehicles, such as trucks and public transport. But after the shootings, Israel responded by banning all Palestinian traffic from several roads, including part of Route 60.

Maariv, a daily newspaper, reports that the army has been told to start implementing a plan to make such bans permanent, though government spokesmen say there has been no final decision. Israel is at work (slowly, after foreign donors last year refused a request for funding) on building and upgrading roads, bridges and tunnels to let Palestinians travel between their towns without ever turning on to a road used by Israelis.

That will complete the division of the West Bank into two road networks (see map). Israel says this will make Palestinians' lives easier: there will be less need for checkpoints and roadblocks. Perhaps so; but the Palestinian highways will be narrower, more winding and more hilly, so trips will take longer and cost more. They also tend to go through towns instead of by-passing them, which will mean huge snarl-ups of trucks and public transport. All this will hurt the Palestinian economy.

Signs of the creeping separation have been there for a while. The UN's Office for the Co-ordination of Humanitarian Affairs has found that the number of fixed checkpoints and roadblocks in the West Bank has dropped by at least a third this year, in line with an Israeli promise in February to ease restrictions. However, that has mostly helped movement between small Palestinian villages and their nearby urban centres. The highways between the main towns, on the other hand, are increasingly lined with fences and barriers to prevent access, and there are now three times as many “flying checkpoints”, which pop up and turn back Palestinian cars at random, discouraging them from using roads that may one day become Israeli-only.

What does all this mean for the future? For two years Israel has been building a barrier through the West Bank—for security, say the Israelis. It mostly hugs the pre-1967 border (the Green Line), but bites off the areas with the biggest settlements too, taking about 10% of the Palestinians' West Bank territory. The ugly barrier, reminiscent in places of the Berlin Wall (about 7% of it so far consists of nine-metre high concrete slabs), has attracted international condemnation. But the common assumption is that it is intended to be an eventual international border and that the Jewish settlements on the Palestinian side, with some 70,000 residents, will be evacuated in a peace deal, along the lines apparently on offer by Israel at Camp David in 2000.

Yet Israel need be in no hurry. Though less visible, and almost ignored amid the international outrage, the dual road system is much like the barrier. It cuts settlers off from Palestinians, making them safer from attack and securing settlements deep inside the West Bank, not just those close to the Green Line. As with the barrier, each terrorist attack will not only further postpone the peace process—Israel says there can be no progress until the Palestinian Authority (PA) meets its road-map obligation to disarm militants—but will reinforce the argument for keeping the system in place.

Meanwhile, if the peace process remains stuck, it is not hard to see how Israel might stage another unilateral pullout. Since the success of the Gaza disengagement, Israeli support for another such move, though still in the minority, has increased, according to Tel Aviv University's monthly Peace Index poll. An early draft of the disengagement plan included about a dozen more settlements in the middle of the West Bank, which in the end were left intact. A few other isolated settlements are now lobbying the government to be relocated into Israel. Any of these could, in time, become the focus of Israel's next unilateral withdrawal. And that, argues Mr Malley, could serve both Israeli and PA interests. Israel would give up strategically inconvenient outposts while saying, once again, that it is making concessions to the Palestinians. The PA would, once again, make political capital out of Israel's withdrawal, without the humiliation of having given its consent to an unfair deal.

But terrorist attacks would continue to kill Israelis. The West Bank's balkanisation would continue to impoverish Palestinians. Israeli settlement-building would make a viable Palestinian state ever harder to achieve: this summer Israel, ignoring its own road-map obligations, announced plans to increase the number of settlers in the Jordan Valley, in the east of the West Bank, by 50% in one year. It is still building hundreds of dwellings a year in other settlements too.

Israeli strategists these days tend to see the Jordan Valley not as an essential “security buffer”, but as a large bargaining chip. Populating settlements will give them more weight in any future negotiations. There are already nine times as many settlers east of the barrier as the number evacuated from Gaza, and they include the most hardline ideologues. If enough time goes by, the Palestinians may have little choice but to accept a Swiss-cheese state, comprising most of the West Bank but riddled with settlements, in which travel is severely hampered. And in the worst case, if there are no peace talks, the dual road network lets Israel contemplate pulling out from up to 40% or 50% of the West Bank's territory unilaterally, while keeping most of its settlements.

What might stem this grim onward march? The PA's most effective weapon would be incontrovertible signs that it is bringing violence under control. Mr Abbas's slow progress on this score has been hampered by PA infighting, his own weakness as a leader (though polls show he is growing more popular), and the fact that the PA forces still cannot operate in Israeli-controlled areas of the West Bank. And since Israel, not surprisingly, responds to attacks by clamping down, as it did this week, each attack makes the job harder—and strengthens Israel's determination to keep its systems of separation.

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Economist.com WORLD AFRICA & MIDDLE EAST

The International Criminal Court

Catching a Ugandan monster

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The new world court for the grisliest war-criminals struggles to get going

Get article background

IT WAS not the best way for the world's first permanent war-crimes tribunal to go about proving itself to an often sceptical world. The International Criminal Court (ICC) has finally announced what everyone else had known for weeks: that it has issued arrest warrants—the first since its creation in 1998—for Joseph Kony, leader of the rebel Lord's Resistance Army (LRA) in Uganda, and four henchmen. Despite this public-relations bungle, issuing the warrants marks a big step towards ending impunity for those guilty of the worst atrocities. Putting Mr Kony in the dock in The Hague would be an even bigger one.

For the past 19 years, the LRA, whose leader claims to have been sent by God to save Ugandans from the forces of evil, has terrorised the Acholi people in northern Uganda, killing and maiming, and abducting more than 20,000 children for use as child soldiers, sex slaves and porters. In gruesome initiation rites, many have been forced to club, stamp and bite to death friends and relatives, sometimes even their own parents, then lick their brains, drink their blood and even eat their flesh. Those who have tried to escape have either undergone a similar death themselves or had lips, noses, breasts and limbs hacked off in retribution.

In an attempt to escape the rebels' raids, nearly 2m people, some 90% of the population in the three main Acholi provinces, live in overcrowded and disease-ridden camps for “internally displaced people”. But even here, they are far from safe. Hence the pathetic ragtaggle streams of “night commuters”, barefoot children as young as five, who trudge many miles every night to sleep in the relative safety of the towns before returning home at dawn.

In issuing its arrest warrants, the ICC concluded that there were “reasonable grounds” to believe that Mr Kony, Vincent Otti, his deputy, and three of his other top commanders had “ordered the commission of crimes within the jurisdiction of the court...including murder, abduction, sexual enslavement, [and] mutilation”.

Unable to destroy the rebels by armed force or to lure them from the bush with the promise of an amnesty, Uganda's president, Yoweri Museveni, decided nearly two years ago to refer the conflict to the ICC. Local community and church leaders, along with some human-rights organisations, protested that this would mean the end of a peace process that Betty Bigombe, a former government minister, had been trying to broker for years. Accusing the fledgling court of trying to raise its profile, they called on Mr Museveni to withdraw his invitation to the court to intervene. Most Acholis, however, probably want a trial and punishment for their tormentors.

Under its charter, the ICC's chief aim is to put an end to impunity for the perpetrators of just such horrors as those carried out by the LRA. If Mr Kony and his gang were allowed to get off scot-free as part of a peace deal, the court argues, this would encourage others to think they can get away with similar atrocities. However, issuing arrest warrants is one thing, catching the culprits quite

another. If Mr Kony has evaded the full force of Uganda's army for the past two decades, what hope has the court of nabbing him, with no troops or police at its disposal?

More than before. The peace deal between the Sudanese government in Khartoum and Sudanese rebels in the south has made it harder for the LRA to hide in Sudan. Since 2002 Sudan's government has allowed Uganda's army to enter the southernmost tip of Sudan in pursuit of the LRA; now it has agreed to let it move further north. The arrest warrants should also increase international pressure to catch Mr Kony and his top men. Furthermore, now that the names of those wanted by the ICC are out, other LRA rebels may be encouraged to surrender and benefit from the Ugandan government's amnesty, without fear of being hauled before the court.

The UN's war-crimes tribunal for the former Yugoslavia was widely mocked when it first issued an arrest warrant for Slobodan Milosevic, then Serbia's president, on charges of genocide and other war crimes. But he is now on trial in The Hague. True, the likes of Radovan Karadzic, the Bosnian Serb leader, are still at large ten years after being indicted for similar offences. So it may take many years to arrest Mr Kony. But the ICC can afford to wait: unlike those other war-crimes tribunals, it is a permanent institution, with no time limit on its ability to bring prosecutions.

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Economist.com WORLD AFRICA & MIDDLE EAST

Côte d'Ivoire

Hopes of peace still look thin

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A presidential election scheduled for this month has been put off. What next?

AFP

Gbagbo gets another year

FOR months Ivorians had been worrying about whether their country would be able to have a presidential election, scheduled for October 30th, on time. It was seen as the way out of the crisis that began three years ago, when rebels known as the New Forces conquered the north of a country once considered one of the richest and most stable in West Africa. But with the country still divided, and electoral lists not drawn up, the election was postponed. Now Ivorians are anxiously wondering what will happen after President Laurent Gbagbo's five-year mandate runs out at the end of this month, with threats and declarations flying in all directions.

Mr Gbagbo insisted that he would stay in office until an election could be held. The unarmed opposition and the New Forces rebels wanted a transitional government to lead the country to the polls without him. The African Union (AU) and the United Nations seem to have come down on Mr Gbagbo's side. On October 13th the UN Security Council adopted AU proposals giving Mr Gbagbo up to another year in office, but with the caveat that he cede some of his powers to the prime minister.

By midweek, the exact UN resolution had not been drawn up, but was expected to recommend the appointment of a new prime minister, acceptable to all sides, with full control over the cabinet. As Mr Gbagbo's supporters danced, literally, in the streets to celebrate his continuation in power, the opposition demanded that the prime minister should run the government and that the president should become a figurehead, like the queen of England. For their part, the New Forces rebels are insisting that the new prime minister should come from their own ranks.

As usual, the Ivorian elite seems unable to agree on anything. But at least the decision to postpone the presidential election has reduced the tension created by the impending October 30th deadline. “Everyone was worried about what would happen after Gbagbo's mandate ran out,” says one diplomat who considered a return to violent conflict a real possibility. “Now everyone can breathe a bit more easily. But that doesn't mean the problems have been resolved, only pushed back.”

Indeed, it is hard to imagine the New Forces accepting another year of Mr Gbagbo, the man they fought to depose, as president. They are already muttering darkly about “taking their responsibilities” if he is still in power after October 30th. To prevent mayhem, there are 10,000 French and UN peacekeepers in Côte d'Ivoire, and the forthcoming UN resolution may boost their number.

But other dangers could flow from the AU/UN proposals. The terms, once again, are vague. “What is important in the decision is to have a clear framework,” says Antonio Monteiro, the UN official with special responsibility for the election. “That is what I want, and I very much hope that the resolution will not have confusing or controversial elements.”

The key issue is who really runs the country during Mr Gbagbo's 12-month grace period. Mr Monteiro has chivvied all parties into setting up an independent electoral commission as a first step on the way to fair elections. Yet these will only happen if all sides believe it is in their best interests to participate, or, less likely still, are prepared to put the interests of the nation before their own.

Mr Monteiro talks of creating momentum and of shaming all sides into working towards the polls. But the New Forces will only disarm, a precondition for the election, if Mr Gbagbo disbands the militias supporting him, and even then it may be difficult to persuade men who have gained power via the gun to lay down their weapons. As for Mr Gbagbo, he was elected in 2000 in a poll from which his two main opponents were barred. Few believe he could win an open election now.

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Corruption in Russia

Blood money

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AP

From terrorism in the north Caucasus to the boardrooms of Moscow, corruption is Russia's biggest problem

TWO shifty businessmen and one huge bodyguard carrying a large bag enter Vladikavkaz airport, a stone's throw from the cemetery in which the victims of last year's terrorist atrocity at Beslan are buried. They whisper to an airport official, who takes their documents and sees to their check-in. The three men and their un-X-rayed bag are next seen heading for their plane from a side door in the terminal.

Caught out by an obscure regulation, a driver tells a Moscow traffic policeman that he wants to settle things quickly, but without breaking the law. “Too many things are illegal in our country,” grumbles the cop, implying that a more sensible government would make bribery legal as well as universal. So how much does he want? “Give me what your soul tells you.”

Those recent examples are from your correspondent's experience—but corruption in Russia is everywhere. Often, it seems not a by-product of policy and events, but the main reason for them, a stronger force even than resurgent nationalism. It poisons people's relations with the police, bureaucrats and politicians (see chart). And it appears to be getting worse.

Being covert, the precise dimensions of corruption are hard to measure. But trends are discernible. In the latest international “corruption perceptions index” produced by Transparency International (TI), a watchdog, Russia has fallen to rank alongside Niger, Sierra Leone and Albania. A recent survey by Indem, a Russian think-tank, found an enormous hike, since 2001, in the number and size of bribes given by young men and their families to avoid conscription and, relatedly, in those paid to get into universities. (Fixing a court case, Indem found, has got a bit

cheaper.)

Within the armed forces, the graft is astonishing. Andrei, a conscript from Novosibirsk, recalls that his unit was forced to raise cash to buy a car for an officer, by begging and selling purloined military kit. Russia's defence minister was recently obliged to issue a special order designed to stop officers hiring troops out as day labourers, and using them to build dachas.

Indem's most controversial finding was a surge in the volume of bribes paid by businesses, to a total amounting to more than double the federal budget. An exaggeration perhaps; but most businessmen confirm the deterioration. The difference now, says the boss of one building firm, is that bureaucrats take the cash, but don't then interpret the opaque regulations in the way they had promised—the most economically damaging kind of corruption, according to academic studies.

Forbidden means expensive

Another Moscow-region developer estimates that 10% of his costs go in bribes: a project requires 50 licences, and every licence needs a bribe. “It's like the last days of Pompeii,” he says, adding that at least the uniformed extortionists have squeezed out the organised bandits. Big business is less talkative, but no cleaner. Nigeria was good training for Russia, says a western executive. To put it in another way, Russia is a country where top state officials live luxuriously and make decisions which have no innocent explanation.

Faced with a problem that it cannot credibly deny, the usual Kremlin approach is to say that it is not a problem for Russia alone. This has been President Vladimir Putin's attitude to corruption; it is, he says, an issue in all transitional countries. But Russian corruption has some peculiar characteristics. It is partly an age-old function of the country's size and poverty: the tsar in Tolstoy's “Hadji Murad” is convinced it is “a characteristic of officials to steal”. Communism bequeathed little regard for private property or civic duty, and left big networks of patronage dating back to institutions such as the KGB. Next came wholesale privatisation amid weak regulation, and lots of oil money. An optimistic view is that these effects will wear off. Indem did find that even as state officials get greedier, public aversion grows—for instance over the cost of “free” hospital care (though some bribes may simply have become unaffordable).

But Russian corruption doesn't just make life inconvenient, or hold back the economy: it kills people. When two aircraft blew up after taking off from Moscow last year, investigations revealed many ways in which bombs could be put on planes for cash. After the Beslan attack, reporters in Moscow proved it was possible to obtain official documents while using a photograph of Aslan Maskhadov, the Chechen leader who was later killed. The Beslan hostage-takers are thought to have bribed their way across internal borders. And how did over a hundred militants gather and arm themselves before launching the city-wide battle that struck Nalchik, not far from Beslan, last week? “How can we withstand terrorism,” asks Vladimir Lukin, the human-rights ombudsman, “with such a level of corruption?”

It has also prolonged and aggravated the terrorists' main grievance: the conflict in Chechnya. Poor as the region is, it is lucrative: there are kidnappings, many of them, says Mr Lukin, corruption-related; embezzlement of reconstruction money; smuggling; and even, it is said, arms sales by

the army to insurgents. Elsewhere in Russia, security services are said to control poaching and prostitution.

Across the north Caucasus, corrupt local elites have monopolised the economy. The new president of Kabardino-Balkaria, of which Nalchik is the capital, this week conceded that unemployment and “not being able to start up one's own business without links to the authorities” had pushed youngsters towards militant Islam.

The cost in lives is one reason why corruption in Russia is not, as some say, an efficient way to live with over-regulation. Corruption, says Mikhail Grishankov, chair of a parliamentary anti-corruption committee, offers the same efficiency as the justice system in “The Godfather”. Paying up encourages further extortion, ultimately raising costs all round. Worse, the traffic policeman who takes your bribe may take one next from a drunk—or a terrorist. In a country where money talks, it is easy to deliver a bomb, says Elena Panfilova, of TI's Russian chapter.

Corruption, says Georgy Satarov of Indem, is like pain, a symptom of other problems. In Russia, they include a neutered parliament, subservient (and sometimes intimidated) media and a suborned judiciary. But experience elsewhere suggests that measures short of wholesale democratisation have some impact. Rasma Karklins, of the University of Illinois at Chicago, says “islands of integrity” can be established in regions or institutions; high-profile prosecutions can help.

Since corruption was a key motive behind the revolutions that have ousted three post-Soviet regimes in the last two years, the Kremlin should worry. It has tried raising some official salaries; corrupt bureaucrats, like the taxman arrested in Moscow this week for soliciting a $1m bribe, are sometimes punished. But in general what Ms Karklins calls a system of “mutual blackmail” seems to prevail. Officials are promoted because of, not in spite of, their corruption, which makes them pliable. “A corrupt official is a more loyal official,” says Ms Panfilova. Punishment happens when spoils aren't shared, or an official steps on to somebody else's turf.

Consider Mikhail Kasyanov, prime minister and head of the (inert) presidential anti-corruption council until his ouster last year. After signalling his own presidential dreams, Mr Kasyanov faced damaging allegations—of corruption.

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Economist.com WORLD EUROPE

France's national hero

Cometh the hour, cometh the ghost

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When France frets, a general lends posthumous reassurance

WHEN in doubt, cite Charles de Gaulle. Like the general himself, that old political habit is making a glorious comeback. It is now 61 years since the statesman returned to a liberated homeland, 47 years since he founded the fifth republic, 35 years since he died. But his stature in French affairs is growing.

Take the row between Dominique de Villepin, the prime minister, and Nicolas Sarkozy, head of the ruling UMP party, over how fast to reform. Mr de Villepin wants gradualism, Mr Sarkozy a "rupture" with the past. To bolster his case, Mr de Villepin turns to de Gaulle. In 1944, when the general rode into Paris, and in 1958, when he took charge of the nation, was that a break with the past? No, the prime minister insisted recently, the general had affirmed "continuity" with French tradition. Nonsense, said Mr Sarkozy. De Gaulle's constitutional, economic and colonial policies were a clean break with the past.

Earlier this year, before the vote on the Euro-constitution, both camps invoked de Gaulle. Surely, the Yesses said, the great reconciler of France and Germany would have backed a move to entrench European integration, and to project France's voice in a stronger Europe? Nonsense, said the Noes: de Gaulle believed in national sovereignty, and would have hated any weakening of the Franco-German axis. To some Gaullist grandees, like Edouard Balladur, such squabbling is *lèse-majesté*. People should respect de Gaulle enough to avoid "invoking his memory carelessly", the former prime minister insists.

Why the obsession with a leader who left office in 1969? It is not just a matter of his abiding popularity, though this is huge. (Philippe de Gaulle's recent memoir of his father spent months on the bestseller list, and a film inspired by the book will go out this month on prime-time television. Earlier this year, television viewers voted de Gaulle the greatest French person of all time.)

This general isn't merely popular; he is also a prime mover, in a way that has no British or American equivalent: the moral guarantor of today's French state, as well as the Gaullist movement. President Jacques Chirac bears the torch; he was a minister under de Gaulle.

More important, the grand old man is a comforting figure in the midst of an identity crisis. The French are in a fretful mood, over decline, joblessness and political stagnation, and they need some inspiration. "De Gaulle was a magician," says André Kaspi, a history professor at the Sorbonne: "He made us believe we were great again." The general's claims for France's "exalted and exceptional destiny" may, to today's ear, sound over the top. Yet in the collective imagination he remains, for all his flaws, a unique symbol of pride. "France doubts its own identity," adds Mr Kaspi: "The memory of de Gaulle is a search for renewed self-esteem."

Economist.com WORLD EUROPE

German politics

Sensible singers looking for a song

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From The Economist print edition

Germany's new ministers look decent and worthy—but first they must learn to sing the same tune

Get article background

IF COMPETENCE and arrogance go together, then Joschka Fischer, Germany's outgoing Green foreign minister, is a prime example. In a valedictory interview, after saying last month that he no longer would be his party's front man, he could not resist boasting. “I was one of the last live rock'n'rollers in German politics”, he said. “Now, in all parties, the playback generation is taking over.”

He had a point: Germany's new government, now complete with the nomination of the last ministers on October 17th, is anything but a rock'n'roll band. Yet it is no mere combo of playback politicians either. Perhaps the best metaphor, for the cabinet's inner circle, is an ensemble of solid studio musicians. They may yet prove to be the right line-up for the grand coalition of Christian Democrats (CDU), its Bavarian sister party the Christian Social Union (CSU) and Social Democrats (SPD) as it starts composing a political agenda.

At any rate, the contrast could not be starker with the outgoing cabinet, dominated by men with pop-star-sized egos: Mr Fischer and Chancellor Gerhard Schröder, of course, but also Otto Schily and Wolfgang Clement, the interior and economics ministers respectively. They seemed keener on self-promotion than on “the slow drilling of hard boards”, to quote a famous definition of politics by the father of German social thought, Max Weber.

Tuning up for a steady performance

Portfolio (background)	Main challenge as minister	Political priorities	Assets	Liabilities	Ou
CDU/CSU					
Edmund Stoiber, Economics (Bavaria's premier, CSU boss)	Get the economy going	Defend CSU and Bavarian interests	Good question, ask Jacques Chirac	Disloyal, thinks he would make the better chancellor	Re
Wolfgang Schäuble Interior (Former CDU boss)	Terrorism, immigration, World Cup security	Ensure CDU support for government policy, help Ms Merkel	Mr Loyal, open-minded intellectual, safe pair of hands	Would be better cast as foreign minister	Pr bu ra
Thomas de Maizière, Chief of staff (Saxony's interior minister)	Co-ordinate the government with state governments	Defend interests of eastern states, co-ordinate	Multi-talent from the east	Big ambitions, smaller ideas	Pr
SPD					
Franz Müntefering, Labour/vice-chancellor (Chairman of SPD and its parliamentary group)	Unemployment, labour-market reform	Keep the SPD under control, wait for credible successor to emerge	Political organisation man who keeps his word	Puts the party *über alles*	Pra he fu
Frank Walter Steinmeier Foreign affairs (Chancellor Schröder's chief of staff)	Come up with ideas to put the EU back on track	Protect Mr Schröder's legacy	Knows it all (in German politics at least)	Something of a control freak, no Anglophile	Ev th
Peer Steinbrück Finance (former premier of North Rhine-Westphalia)	Fight the budget deficit and reform the tax system	Further his chances to become vice-chancellor	A public finance (and Churchill) buff, excellent English	Lacks party support	Lik Th

Source: *The Economist*

The new government (see table) has an entirely different style. It exemplifies what Wolfgang Nowak, of the Alfred Herrhausen Society, a think-tank, has called the "new rationality": most of the ministers are unexciting but capable. The only one who has the ability to sing catchy political melodies is Edmund Stoiber, the CSU boss set to become economics minister,

Mr Stoiber's insistence on solo tunes can sometimes be painful on his partners' ears. Calculating that it might help him boost the CSU's dented popularity, Mr Stoiber demanded the economics portfolio: that meant that the politically risky—but also more powerful—finance ministry went to the SPD. To neutralise a potential rival as CSU leader, Mr Stoiber forced Ms Merkel to accept Horst Seehofer as farm minister. That was hard on her: Mr Seehofer had often upset Ms Merkel with views that were too far left for her tastes.

Putting these moments of disharmony aside, why such an emphasis on rationality and common sense? This signals a change in Germany's political culture, largely triggered by the economic crisis, argues Karl-Rudolf Korte, a political scientist at Duisburg-Essen University. Germans, he says, no longer want showmanship; they yearn instead for realism and solid leadership.

Yet the shift from self-promotion to seriousness reflects supply as well as demand, and the effects of generational change in German politics. Having already lost much talent to the Greens, the SPD suffers from an ageing group of leaders—many of them "68ers"—who have left little room for newcomers. That is why the party must now rely on solid, experienced politicians and even one senior civil servant. And the two relative youngsters who have made it into the cabinet also seem to be rather sensible sorts—although traces of Mr Schröder's flashy side are visible in Sigmar Gabriel, the former premier of Lower Saxony and future environment minister.

The CDU, for its part, is still hurting from the reign of Chancellor Helmut Kohl, who left his party politically drained. While some youngish politicians have gained positions of power under Ms

Merkel, they still lack the experience for the top jobs. And the party's heavyweights, all rivals of Ms Merkel's, have preferred to keep their jobs as state premiers. Instead, she recruited two confidantes, both also more matter-of-fact types: Annette Schavan and Ursula von der Leyen, two state ministers, who will hold the portfolios for education and the family respectively.

Whatever the reasons, the result is not inspiring. The flip-side of the new rationality, says Warnfried Dettling, a political analyst, is that the government may not be able to present a persuasive vision of where reform should lead over the next 20 years. That's a big drawback after an election in which more than half the electorate voiced nervousness about the future.

A more immediate task for Germany's new political performers is learning to read from the same score. But coaxing some political and ideological harmony out of this multi-pitched government is not going to be simple.

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Economist.com WORLD EUROPE

Italy's violent politics

More ballots, more bullets

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While deepening Italy's democracy, the primaries showed a dark side too

THE winner got three-quarters of the vote. A rival claimed the ballot was rigged. And, in an outlying polling station, a gunman murdered a local bigwig. Not another volatile, double-barrelled enclave in the post-communist world, but Europe's fourth-biggest economy, Italy.

On October 16th, the left-wing opposition held what was slated as Europe's first primary election, to choose a candidate to run against Silvio Berlusconi for the prime ministership next year. It was hard to say what it did more to demonstrate: the shrewdness of the winner and originator of the primary, Romano Prodi, or the disturbing abnormality of the country he aspires to govern again.

When Francesco Fortugno, deputy governor of the southern region of Calabria and a member of the centre-left Democracy and Freedom party, went to vote, he was shot and fatally wounded by an apparently professional assassin. His death appeared to be the work of Calabria's organised crime syndicate, the *'ndrangheta*, and a reminder that much of southern Italy is under the sway of mobsters. Murder was not the only way the south impinged. One of the primary candidates, Clemente Mastella, a former Christian Democrat and leader of a small party that draws most of its support from the Mezzogiorno, announced he was leaving the opposition alliance because, he claimed, the vote had been fixed in advance.

Government politicians, too, questioned a ballot that owed much to the organisational capacity of the biggest opposition party, the formerly communist Democrats of the Left. The justice minister, Roberto Castelli, branded it a “Soviet-style political campaign”, arguing that since the polling had not been independently monitored, there was no reason to treat the results as credible.

These were surprising on at least two counts. They indicated that 4.3m votes were cast—more than double the most optimistic forecast—and that 74% went to Mr Prodi. His main rival, Fausto Bertinotti of the hard-left Communist Refoundation party, whose supporters had been expected to turn out in force, was credited with 14.7%. None of the other candidates gathered as much as 5%.

An exultant Mr Prodi called the outcome “a dream”. Was it anything more? The best reason for thinking it was more than a fantasy came from the opposition leaders themselves, who acted as if the results were accurate. Even Mr Mastella softened his tone after discovering he had finished third. He and his counterparts appeared to be genuinely buoyed by the evidence of their followers' enthusiasm and, most importantly for the future, seemed to grasp the point that, by voting for Mr Prodi, an overwhelming majority of their supporters had also opted for his favourite cause—unity.

As a former president of the European Commission and the only man to have beaten Mr Berlusconi on the hustings—in 1996—Mr Prodi is widely liked and respected on the left. But lacking a party of his own, he has often had a difficult time imposing his authority on his squabbling lieutenants. Following the primary, a novel tone of respect was audible in their references to him.

The leader of Democracy and Freedom, Francesco Rutelli, signalled he would shelve plans for his party to run alone for some of the seats in parliament. This was a prudent move, if only because Mr Berlusconi is trying to change the rules for the next election, and the new ones reward compact alliances. It looks increasingly likely that the change will be approved by parliament, and pundits agree that it should help the right. The opposition's curious experiment has put new wind in Mr Prodi's sails and given it an undisputed captain. But if he is to outrace Mr Berlusconi, his crew must somehow be induced to desist altogether from rocking the boat. The primaries were only a start.

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Georgian culture

The art of diplomacy

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Georgia may be poor but its heritage is rich

AS ANY diplomat from Britain, Austria or Turkey can tell you, handling the legacy of a vanished, far-flung empire is a tricky business. But for Georgia, the gap between old glory and present vulnerability is especially wide.

Today's Georgia is diminished by war, buffeted by geopolitics and recovering from post-Soviet chaos. But 800 years ago the country was a mighty military, cultural and ecclesiastical force. Its greatest monarch, Queen Tamara, defeated many foes (including her first husband) and built fine monuments. In her time, Georgia also had a big stake in the Christian life of the Holy Land. From Jerusalem to the Balkans, Georgia's priests, artists and church-builders were active and respected. So too were its poets, like Shota Rustaveli, the national bard who dedicated an epic to his beloved queen.

In between seeking western aid and coping with power cuts, modern Georgia has pledged to keep a wary eye on every place where churches, inscriptions and frescoes testify to its golden age. That includes Greece, Turkey, Bulgaria, Romania and above all, Israel. Last year, Georgians were enraged when a fresco of Rustaveli, in a Jerusalem church under the care of the Greek Orthodox Patriarchate, was defaced, then badly restored. This year, a better restoration was done, but Georgians now want a promise that in all future restoration their own experts can take part. They also want to stop the seepage of Georgian frescoes and icons, supposedly under the Patriarchate's care, on to the art market. Several times, Georgia has had to use its meagre resources to buy back pieces of the national heritage. The hope is that things will improve with the recent election of a new Jerusalem Patriarch, after his predecessor was ousted under a cloud of scandal.

Georgia's ties with Israel are good, thanks to a thriving Georgian-Jewish community with happy memories of its homeland. Georgia also gets along with Greece, amid a fug of sentimentality over legends about the Argonauts that link the two nations. But can these warm, fuzzy feelings translate into better protection for an ancient culture? That will be a challenge for Gela Bezhuashvili, who succeeds Salome Zourabichvili, the French-born diplomat who was sacked, after a power struggle, as Georgian foreign minister on October 19th.

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Charlemagne

As they don't like it

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Europe's demographic disaster is self-inflicted but not terminal

EUROPEAN leaders seem to agree with Shakespeare's character Jacques: all the world's their stage, and Europe's men and women must work out which part to play in the endless drama of international affairs. The touchstone of every oration about Europe's future is globalisation and how to respond. Britain, as tenant of the European Union's revolving chair, will host a well-choreographed summit next week on that very topic.

Obviously globalisation matters. And by and large Europeans are not adapting very well. Yet the biggest problem facing their continent (and their welfare states) is not the result of a new twist in the global plot. It would exist even if Europeans had the world stage to themselves. The problem is demography, the fact that the old continent is growing even older. Jacques's seven ages have got out of balance.

In the last half of the 20th century, Europeans enjoyed a few, short decades of benign age structure. Working-age adults—what Shakespeare called the lover, soldier, and justice stages—were numerous. And because they had fewer puking infants, and not many toothless oldies to look after, they enjoyed the fruits of an unusually light burden of dependency. This happy period is about to end.

Natural decrease has begun in Germany, Italy and Greece—and those populations would be falling, were it not for immigration. By 2050, on current trends, the largest segment in the EU's population will be Shakespeare's “sixth age”, 65- to 69-year-olds. Half the population will be over 50; and the proportion over 65 will be as large as the under-15s, creeping like snail unwillingly to school. Such an age structure would be unprecedented.

All this reflects medical advances and greater personal choice on family size. Globalisation had nothing to do with it. It is true that global capital flows make it easier to support oldies by boosting returns to pension funds. If globalisation also makes countries reform and produce more, that will help too. But the European Commission says it would take an extra half percentage point of productivity growth over 20 years to meet the costs of ageing; over such a long period that is a tough target.

If you count migration as part of globalisation, then immigration by working adults could in theory maintain the size of the population and the share of workers in it. But to have any effect, immigrants would have to arrive in unfeasibly huge numbers. The British government worked out that, to maintain the current ratio of those aged 15-64 to those aged 65 or over (what wonks call the "support ratio" or "dependency ratio"), Britain would need a million immigrants a year for the next two decades.

So can nothing be done? Many Europeans fear so. As their continent ages, they think the whole place is doomed to "mere oblivion, *sans* teeth, *sans* eyes, *sans* taste, *sans* everything". Yet there are solutions and chinks of light.

The first thing to note is that the overall ratio figure is misleading. It was 4.25 in the EU in 2000 and will fall to 1.86 in 2050 (ie, there will be fewer than two people of working age to maintain each pensioner). This is unquestionably bad; in America, the ratio will remain over 3. But it is not uniformly disastrous. European countries come in three distinct categories, depending on how bad their dependency problem will get.

In the merely worrying group are France, Britain, the Netherlands and Norway. All have relatively high fertility rates; their support ratios remain well over 2 until beyond 2050. In the middle category—call it the dreadful—are Germany and most of the new EU members, like Hungary. There, the ratio will fall to between 1.5 and 2. The members from central Europe have a slightly different age profile from western European countries. They did not have the same big baby boom, so their populations are ageing more gently (and manageably); on the other hand, their birth rates are now very low, hence the future problems. In the third category—the catastrophic—are Mediterranean states such as Italy and Spain. They kept traditional family structures later than in northern Europe—and fertility rates then plunged. Their support ratio will sink below 1.5 by 2050.

In all this, believe it or not, there are crumbs of comfort. A ratio of 2.5 sounds awful. Yet some countries cope with that now. The nominal ratio of about 4 assumes people retire at the official age, usually 65. In practice, the actual retirement age almost everywhere is lower since people stop work early. That makes the real support ratio in some countries, like Britain, about 2.5 already. It will fall, of course, but this example shows it is possible to manage with little more than two people of working age for each pensioner.

Not doomed after all

As a new study by the OECD argues, demography is not destiny. Things like the retirement age, workforce participation and training, and the way pensions systems work are all determining how ageing affects a society. Most countries have not realised this. Many encourage early retirement or penalise those who work past the official age—making their dependency problem worse. Most have treated ageing largely as a matter of pension reform. But pension reform is not enough. In Mediterranean countries, fewer than half of those between 50 and 64 work. If they could increase the participation of 50-64-year-olds to Nordic levels, where two-thirds have jobs, they would see a big reduction in their future dependency problem.

The demographic facts increase the case for welfare reform, and may be more persuasive than

just asserting that “we must adapt to globalisation”. Still, some of globalisation's effects are distant, while looking after grandma is not. So EU governments have some explaining to do: they might try the gentle approach of Shakespeare's Duke who, when Jacques finishes, offers comforting words to an elderly retainer: “Good old man...Give me your hand and let me all your fortunes understand.”

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Education white paper

The permanent revolution

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Yet another white paper heralds more change for punch-drunk state schools

Get article background

IN 1997 and 2001 Labour won power with manifestos that declared education to be its top priority. It took these victories as a mandate for activity: 11 white and green papers, serial changes to the national curriculum, reforms of old qualifications and the introduction of new ones, beefing up the schools inspectorate and performance league tables, new ways to expand some schools and close others, creating academies and dumping the Tories' scheme for directly funded schools. It has also spent freely: state education has risen from 4.7% of GDP in 1997 to 5.5% today.

And yet, after all that, education is still at the top of Labour's to-do list. Its 2005 election programme again put education first and next week the government will add another white paper to the series, with legislation expected to follow early next year. Tony Blair, with an eye to his legacy, worries about his government's failure to improve the worst-performing state schools. Eager to prove his unflagging zeal for reform, he wants one last shot at dragging them up to the standard of the rest.

The government's vision for secondary schools has been to provide variety—schools that specialise in particular subjects, religious schools, schools that are run more or less independently of local government—and to let parents choose. It is adamant that this combination of variety and choice has pushed up standards, pointing to increases in the proportion of students achieving five GCSEs at grade C or above. Much of this progress is genuine, though some is illusory, as schools have learnt how to play the league tables by directing students towards easier subjects and vocational qualifications. But it has not occurred uniformly: David Bell, head of the schools inspectorate, this week accused a quarter of schools of offering pupils “nothing better than mediocrity”.

To some extent, the latest plan is to continue along the same path, but to force the pace. The government has been saying for some time that it is keen to see successful schools expand, even if this forces less popular schools to close. To bring this about, it is abolishing the Schools Organisation Committees that it set up soon after it was first elected. These bodies, representing local vested interests—school governors, religious leaders, union representatives—could veto expansion in favour of the status quo, and usually did.

There will be a wider reduction in the role of local government, too. Mr Blair wants every school eventually to apply for foundation status, which means greater freedom over budgets, assets, recruitment, admissions and the syllabus. In a recent speech to the Local Government Association, the education secretary, Ruth Kelly, said she wanted councils to become “the commissioner rather than the provider” of educational services.

It will also become easier for independent religious schools to move into the state sector without having to show they have lots of capital to bring their facilities up to scratch. The five Muslim

schools now in the state sector will probably soon be joined by another hundred or so, and the single Hindu state school, announced earlier this month, may not be alone for long.

There may be some tinkering with school admissions, with popular schools encouraged (not compelled) to allocate places randomly or admit balanced numbers of children of differing abilities. There will be “choice advisers” to help poorer parents consider the schools on offer and fill in application forms, and the rules governing subsidised transport to school will be updated so that poorer parents who choose to send their children to distant schools will be eligible even if there were places available at nearer schools.

These measures will help to persuade Labour backbenchers, councillors and teaching unions—who fear the government is loosening its hold over education—that something is being done to stop popular schools being colonised by the middle classes. But they will be unlikely to make much difference. Much as the government might like to “balance” intake between more and less popular schools—after all, wealth and ability are strong predictors of educational success—it won't want to risk accusations of social engineering and the wrath of vocal middle-class parents.

Perhaps the most controversial measures in the white paper will deal with the way schools are led, and how they relate to each other. Popular schools will be invited to take over failing ones, and independent schools to federate with state schools, perhaps sharing head teachers and boards of governors, and collaborating on teacher recruitment and training, and financial and asset management.

That will require commitment and expertise. There are inspiring examples of it working: the United Church Schools Trust (UCST), a federation of 11 fee-paying schools, now manages a number of state schools through a subsidiary charity. The chief executive, Sir Ewan Harper, says the trust's long experience of working as a federation and strong social mission were essential to the decision to become involved with state education.

Others are more wary, citing the government's unwillingness to cede control. Dulwich College already runs two independent franchises, in Beijing and Shanghai, and the headmaster, Graham Able, says he could imagine this working in the state sector—“but the state has a habit of promising freedom and then not delivering it.” Chris Woodhead, chairman of Cognita, is more scathing. The for-profit educational provider would become involved, the former chief schools inspector says, only if it had management freedom and financial rewards—“and I would be amazed if any such things were on offer”.

Labour's education policy has been a succession of incremental and piecemeal changes, always constrained by the need to reach compromise within the party, and between Mr Blair and the educational establishment. Now the relentlessness of change may itself be the obstacle. Barbara Harrison, chief executive of the Girls' Day School Trust, which runs 25 independent schools, says that before the trust could follow UCST's lead it would need to be convinced that government policy would be stable. As she says wryly, “there have been an awful lot of white papers”.

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Economist.com WORLD EUROPE

Army reform

Special help

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The best soldiers are getting back-up

THE defence budget is shrinking, the cost of high-tech warfare soaring. How is Britain to remain a front-line military power? One answer, in a favourite phrase of warmongering tabloid newspapers, is to “send in the SAS”—the Special Air Service, perhaps the best of all elite regiments.

Over the past decade, British special-force (SF) fighters, comprising the SAS and their naval sister unit, the Special Boat Service (SBS), have been more busy in more places than at any time since the SAS was founded—to play merry hell behind German lines in 1941. First came peacemaking in the Balkans, then wars in Sierra Leone, Afghanistan and Iraq, and counter-terrorism all over the place. The burden, which springs from America's war on terror and an interventionist British foreign policy, will not be lifted soon. And yet the combined strength of the SAS and SBS is only believed to be around 400 men.

Alas, their number cannot simply grow. Although a fourth SBS squadron is being raised from the toughest marine commandos, recruiting many more men would entail easing the entry requirements. Better to train and dedicate high-grade infantrymen to support SF operations, freeing the best soldiers for the most demanding tasks. Hence the Joint Special Forces Support Group (JSFSG), an outfit modelled on America's army rangers, and whose first members, from the parachute regiment, are enjoying a preliminary outing with the SAS in Baghdad.

One of several army reforms announced in December, the JSFSG will become partially operational next April and ready by 2008. At its heart will be the Parachute Regiment's 1st battalion, which will be cut to 476 soldiers—in effect, losing a company of 70 men. It will also have a company of marine commandos and a similar number of experts from the air force, including forward air-controllers. The support group is to be led by the paras' commanding officer and dedicated to its new role; the battalion has already been removed from the infantry order of battle.

The army is cockahoop. Before the recent shake-up, it faced losing four infantry battalions. Thanks to its canny boss, the JSFSG's architect, General Sir Mike Jackson, it has, in effect, lost only three. That the general himself commanded “1 para” suggests a spot of backroom manoeuvring; he describes the group's formation as “a very good result for the army”.

The SAS and SBS are also pleased. Already the most pampered of British fighters, they can expect dedicated back-up in three main areas. First, as conventional support: the group might, say, secure a fuel supply for forward SF troops. Second, as an auxiliary strike force for SF operations; the paras have already performed this task in Sierra Leone in 2000, when they eradicated a vicious militia called the West Side Boys (led by Commanders Mega-Rapist and Slaughter, among others), after SAS troopers had sprung 11 British hostages from the militia camp. Third, the support group can train the special forces of allies. As these, often from oil-rich Middle-Eastern countries, are typically none too special, the paras are easily up to the job.

The Parachute Regiment, which has always thought itself a cut above the general infantry, is also

pleased. Para recruits will now enter the regiment's 2nd and 3rd battalions for a year or two, before being encouraged to apply for the JSFSG; members of other infantry battalions will also be able to apply. After a similar spell in the support group, most will return to their units. But the best may seek to join the SF. Having learnt SF drills in the support group, they will have done no harm to their chances. Around 175 soldiers brave each of the SAS's twice-yearly six-month selection courses and around 30 are accepted—almost half of whom are paras.

Members of the JSFSG are technically part of the ordinary armed forces. Not so the directorate's other recent addition, the Special Reconnaissance Regiment (SRR), the first new SF unit in half a century, and the only one open to women. The regiment existed in prototype as 14th intelligence company, a plainclothes surveillance unit in Northern Ireland. As military operations scale down there, the new SRR will safeguard its skills. Its record is not unblemished, however. On July 22nd, its operatives were involved in trailing a suspected Islamist suicide bomber in London, later shot dead by police. The man turned out to be an innocent Brazilian.

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The army v private military companies

A shiny shilling

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From The Economist print edition

Britain's best soldiers stand resolute against Mammon

IF SOLDIERING was for the money, the Special Air Service (SAS) and the Special Boat Service (SBS) would have disintegrated in recent years. Such has been the explosion in private military companies (PMCs) that they employ an estimated 30,000 in Iraq alone—and no government can match their fat salaries. A young SAS trooper earns about £2,000 ($3,500) a month; on the "circuit", as soldiers call the private world, he could get £15,000. Why would he not?

For reasons both warm-hearted and cool-headed. First, for love of regiment and comrades, bonds that tend to be tightest in the most select units. Second, for the operational support, notably field medicine, and the security, including life assurance and pension, that come with the queen's paltry shilling.

Although there has been no haemorrhaging of special force (SF) fighters to the private sector, there has been enough of a trickle to cause official unease. A memo recently circulated in the Ministry of Defence detailed the loss of 24 SF senior non-commissioned officers to private companies in the past year. All had completed 22 years of service, and so were eligible for a full pension, and near the end of their careers. Yet there is now a shortage of hard-bitten veterans to fill training and other jobs earmarked for them, under a system for retaining them known as "continuance."

America has responded to the problem by throwing cash at it, offering incentives of up to $150,000 to sign new contracts. The Ministry of Defence has found a cheaper ploy. It has spread the story of two British PMC employees, recently killed in Iraq, whose bodies were left rotting in the sun.

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Terrorism and the law

The non-trial

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Rachid Ramda's case supposedly shows Britain is soft on terrorism. It does not

WHEN Rachid Ramda was arrested by British police at the request of the French government, he was only 25. He was put in Belmarsh prison to wait for a decision on whether he would be sent to France to stand trial over a spate of bombings. One blast, on the Paris Metro, killed eight people.

Ten years later he is still there and still waiting. He had no visitors for the first eight years, according to Ann Alexander, who has visited Mr Ramda in Belmarsh, because none of his friends passed the prison's vetting procedure and no members of his family were granted visas to come to Britain. Ms Alexander says Mr Ramda has spent some of the past year-and-a-half studying for a correspondence degree through the Open University from his cell. Such diversions were prohibited for the first six-and-a-half years in jail, which he spent in Belmarsh's special secure unit.

A judicial review of Mr Ramda's interminable case began this week. Its outcome has some political and diplomatic importance: Mr Ramda has been used as an example by critics, including the French government, to argue that Britain has sheltered Islamists, making London a kind of Beirut-on-Thames. He has also been used by the British government to argue that the law is soft on terrorists and therefore must change. In fact, his case proves neither.

That someone can be imprisoned for ten years without standing trial is clearly a denial of justice—both to the man incarcerated and the victims of the crime. At first glance, Mr Ramda's case makes today's debate on whether the police should be allowed to hold suspects for up to 90 days without charge look like a parlour game. But in fact his ten years in limbo holds no such lesson: Mr Ramda's stay in Belmarsh is in one sense voluntary—he could give up fighting extradition and stand trial in Paris.

The case has taken so long partly because of doubts about the evidence against Mr Ramda. The French police believe that a transfer of £5,000 ($7,900) and repeated telephone conversations link Mr Ramda to one of the bombers, Boualem Bensaid. Mr Bensaid also fingered Mr Ramda when the police took him into custody. But his testimony has been called into question: somehow Mr Bensaid's face and head became bruised two days after he was detained by the French police. The British court would therefore like his testimony to be inadmissible if Mr Ramda is tried in France. But despite the existence of a common European arrest warrant, that level of cross-border co-operation between courts is still rare.

Despite the doubts over Mr Bensaid's testimony, the British government sought to extradite Mr Ramda. The process has dragged on only because it is governed by a law passed in 1989 that was changed in 2003. The old law allowed appeals to be lodged at each stage of the process. A judge first authorised Mr Ramda's extradition to Paris in June 1996. His lawyers appealed. That appeal was rejected by the High Court a year later. Then an application to appeal to the House of Lords was dismissed. So Mr Ramda's lawyers appealed to the then home secretary, David Blunkett. Mr Blunkett approved the extradition in 2001. A year later, the High Court overturned his decision. In April a new home secretary, Charles Clarke, tried again. In total, there have been nine separate

legal proceedings to extradite Mr Ramda.

In other words, the British government is eager to be rid of Mr Ramda and today's law would not give him much protection. Lawyers say the process is now nearing its end. But don't hold your breath.

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Religious buildings

Churchgoing

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Ungodly uses for churches and a second coming for old cinemas

WHEN churches fall out of use, what happens to them? Philip Larkin, in a poem published in 1955, hoped that even when the “ruin-bibbers” and “Christmas addicts” had passed away, someone would still stop by to fill “a hunger in himself to be more serious”. That can still happen when the shell in question is a rural parish—at least when the door is not locked. But redundant churches in towns are increasingly becoming unserious places. Flats, recording studios and libraries are some of the more conventional things they have turned into. Meanwhile, at the booming end of British Christianity, charismatic congregations looking for more room have found the perfect space to worship, free of Victorian gothic tracery: old cinemas.

Religion has long been in decline among Britain's middle classes. Since 1969, membership of the Church of England has fallen from 2.6m to 1.3m and 1,660 churches have closed to business. That represents 10% of the total stock. Rural churches are hard to find new uses for and so are generally either looked after by the Churches Conservation Trust or just left to rot. But churches in towns can be reincarnated. The most common new uses for an old church are as blocks of apartments and community centres, though some have found a more exotic destiny.

St Benedict's church in Manchester has become the Manchester Climbing Centre and a vertical wall with moulded footholds now occupies its tall nave. Churches have been turned into pubs too: Wetherspoon's, a pub chain, has recently taken over an 18th-century Baptist church in Folkestone in Kent, keeping organ pipes and stained glass in place. In genteel Cheltenham, once the sort of town that supplied the Church of England with its most dependable members, people can go and drink in the Pulpit, another ex-church. And if the project is granted planning permission, a church in Westminster in London will soon become a health spa, with a nail bar in the crypt and a sauna in the chancel. The Church of England isn't wild about this, though it acknowledges that even turning a church into a temple to vanity is probably preferable to knocking it down, which is what happens to a fifth of redundant buildings.

It is a different story in Britain's fastest-growing congregations, overwhelmingly made up of immigrants living in cities. Such churches are looking for suitable places to worship and, rather than just take over an old Church of England building—as some white Evangelical churches do—they have moved into old cinemas. In part, this is because these are in the right place: many of the cinemas built in Britain between 1900 and 1940 sprang up in the poorer bits of cities, where their audiences lived. In the 1950s the audiences moved to the suburbs and watched television instead. The picture palaces, with their murals and chandeliers, then became bingo halls or nightclubs. When God-fearing immigrants moved into the neighbourhoods, they made use of these large halls, which could be bought cheaply. In London, charismatic churches have taken over the Astoria cinema in Finsbury Park, the Gaumont cinema in Wood Green and the old Avenue cinema in Ealing, which opened in 1932 with a film about a hit-man hired to murder his best friend.

But the cinemas are a good fit in another way, too. “Most of the churches I've been to in California have squishy cinema-style chairs and big screens for PowerPoint presentations,” says Mike Aldaco,

pastor of the New Harvest Christian Fellowship in Manchester, which was once the Rex cinema. When a church takes over a cinema, these come as standard. The cinema layout also gives the congregation a good view of the stage and therefore of the pastor, who tends to be the star of the show.

Some of the people who run the churches even think that the exotic architecture of the old cinemas helps to attract new recruits, and are prepared to spend a lot of money restoring them. “When a person comes in for the very first time, the looks of the church break the ice,” says Pastor Paul Hill of the Universal Church of the Kingdom of God in Finsbury Park. The church has been busily restoring the cinema's intricate interior, which was designed to give the feel of sitting under the stars in a Spanish village. “When they realise the beauty of the building and its lack of connection with religion, they feel good about it,” says Mr Hill. Maybe even Larkin, a committed agnostic, would have been susceptible to the pull of such period-piece glamour.

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Railtrack

Risky business

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From The Economist print edition

Why doing business with the government can be a bad idea

Get article background

ONE of the most-watched commercial trials in recent years ended last week when the High Court ruled against 49,000 small shareholders in Railtrack, the defunct firm that used to own and operate the rail infrastructure. Yet their days in court were not wasted, since they threw light on grubby government policy-making that is not just distasteful, but which will end up costing taxpayers money.

The shareholders had sued both the government and Stephen Byers, the transport secretary at the time, over his decision in October 2001 to suspend funding to Railtrack, sending it into bankruptcy. Few observers were surprised by the verdict—the shareholders had sued both on human-rights grounds and for “misfeasance in public office”, alleging that Mr Byers had acted with the deliberate intention of harming them. That was always going to be difficult to prove, although they are considering an appeal.

During the trial, Labour's shoddy style of government was everywhere in evidence. Vital meetings between Mr Byers and the company went un-minuted. Worse than sloppiness was the cynicism and political expediency that infected the government's decision-making.

At first, officials planned not to compensate shareholders, arguing that the size of Railtrack's debts had made its shares all but worthless. Small shareholders were treated with contempt. Shriti Vadera, a Treasury adviser, referred to them dismissively as “grannies” who stood to “lose their blouses”. That did not matter, she wrote, since “they added no value to the company”. But while small shareholders could be ignored, she felt it important to placate the big financial institutions. It was only their angry intervention that persuaded the government eventually to offer compensation of 250p per share.

Nor did Mr Byers come out well. The revelation that he had misled the Commons Transport Select Committee over the timing of discussions about Railtrack's future was another stain on his already tarnished reputation. After the verdict, he made a formal apology to Parliament, arguing that it had all been a simple misunderstanding. But the Tories claim to have documents proving that his parliamentary apology was misleading as well. Mr Byers has been referred to the Standards and Privileges Committee, Parliament's ethical watchdog. Behind it all, the Tories say, lurks the brooding presence of Gordon Brown, the chancellor, who was pulling Mr Byers's strings all the while.

Perhaps the most commercially damning revelation was the government's willingness to undermine Tom Winsor, the independent rail regulator, who is charged with protecting investors from ministerial meddling. When Railtrack ran out of money, he had a legal duty to consider giving it more in order to keep the railway running. Yet when he proposed to exercise this power, Mr Byers threatened to pass new laws overruling him.

Stephen Glaister, a transport economist at Imperial College, points out the implications. The railways were privatised along similar lines to the water, energy and telephone markets and similar regulators exist in each industry. “Will the markets accept Railtrack as a special case,” he wonders, “or will they conclude that they should never again risk their money?”

One of the differences between New and Old Labour was supposed to be that Mr Byers and his colleagues had made peace with the market. They have asked private companies to build and run hospitals, prisons and schools. Yet all of these are as politically risky as the railways ever were. The revelations of the Railtrack case risk scaring investors away and will raise the government's costs of raising capital and securing contracts.

To see why, consider the controversy last week after safety scares led to the closure of London Underground's Northern Line—to the frustration of around 600,000 commuters. Ken Livingstone, the mayor, blamed Alstom, an engineering firm with a private-finance contract to maintain the trains. He suggested that Alstom's contract be torn up, and that it was time to renegotiate the public-private agreements that delegate the running and maintenance of the Underground to two private companies, Metronet and Tube Lines (of whom Alstom is a sub-contractor).

Alistair Darling, today's transport secretary, hurriedly dismissed the idea of fiddling with the PPP, although Alstom may yet lose its contract. Yet Mr Livingstone's words will have only added to the anxieties of Tube Lines and Metronet. Because the mayor never hid his opposition to the PPP deal, they spent hundreds of millions of pounds in lawyers' fees trying to make the contracts tamperproof (and probably sought extra profits in case they lost the contract early). The National Audit Office reckons that negotiations and lawyers added around 1.5% to the cost of the deal. After the Railtrack case, other investors may demand the same.

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Public-sector pensions

A row about the pennies

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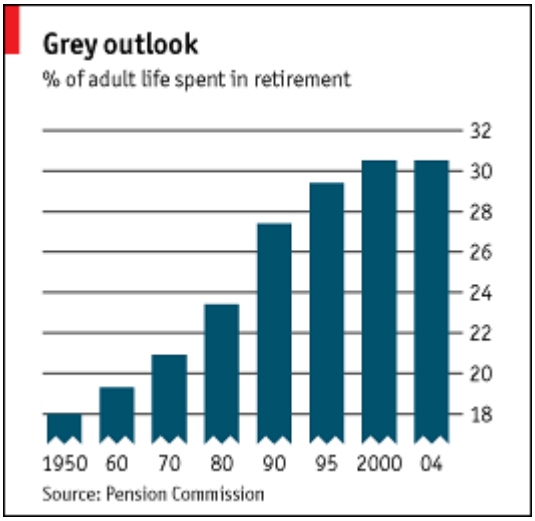
It's the pounds that matter



VENOM dripped from the leader-writers' pens last week after the government struck a deal with the trade unions over reform of public-sector pensions. The unions had threatened the biggest strike in decades unless the government dropped its plans to raise the retirement age for public-sector workers from 60 to 65. Alan Johnson, the minister responsible, had said the week before that rising life expectancy (see chart) had made the case for change “irrefutable”.

Mr Johnson's definition of that word evidently differs from the common one. In the event, the government announced that existing scheme members would get to keep today's arrangements. Only new workers would have to work until 65. That drew a storm of criticism from the press and the business lobby, accusing ministers of cowardice in the face of union threats and making dire comparisons to the dark days of the 1970s.

Yet talk of a climbdown is rather exaggerated. While the government will not make existing public-sector workers retire at 65, the unions have signed up to its original savings target of £13 billion over 50 years—and the point of the exercise was to save money. Rather than decide how to achieve that saving centrally, the government has left it to the individual departments and their respective trade unions. That ought to make it harder for the unions to threaten huge strikes when the new round of negotiations begin. “In a way, I think the government's been rather clever,” says Chris Curry of the Pensions Policy Institute, a think-tank.

If anything, the government's chief sin came much earlier, in its want of ambition. Trimming £260m a year from an unfunded pension liability that ministers say stands at £440 billion, but which independent pension experts put at almost £700 billion, was never a radical policy. Stephen Yeo, an actuary with Watson Wyatt, says that, without reform, the cost of public-sector pensions is predicted to rise from 1.5% of GDP today to 2.3% in 30 years' time. The government's proposed changes, he says, will knock a mere 5% off that. Mr Curry adds that, even for new workers, public pensions will be far more generous than their private-sector counterparts.

That may explain this week's hostility. The public sector has enjoyed a purple patch since Labour came to power. Wage rises have outpaced those in private industry, and median pay for civil servants now exceeds that in the private sector. Hundreds of thousands of new jobs have been created, and while private-sector pension schemes have withered, public ones have remained generous. Private workers resent the idea that their servants in government have it better than they do. Ministers should bear that in mind.

Bagehot

Can David Blunkett do his job?

Oct 20th 2005
From The Economist print edition

Tony Blair's haste to bring back David Blunkett may backfire

IN BRITISH politics, there has never been anything quite like it. Each day seems to visit some ghastly new embarrassment on David Blunkett, the work and pensions secretary. It is hardly ideal for the man who in the next few weeks will issue a green paper that has been billed in advance as heralding the biggest shake-up of the welfare state since its inception 60 years ago.

Last weekend, a Sunday tabloid devoted pages one, four, five, six and seven to an excruciatingly detailed description by a “blonde estate agent” of how Mr Blunkett had “seduced” her with a meal of fish and chips. Mr Blunkett acknowledges there was a relationship, but insists it was “platonic”. On Thursday, Channel 4 was to broadcast a satirical drama, “A Very Social Secretary”. This purports to be a reconstruction of the events that led up to his resignation as home secretary just before Christmas last year—his affair with the married publisher of the *Spectator* magazine, Kimberley Quinn, and the fast-tracking of a visa for her nanny. But its purpose is to make everyone involved, especially Mr Blunkett, appear ridiculous and venal. Repellently, many of the jokes exploit Mr Blunkett's blindness.

Mr Blunkett finds himself in this situation because of the prime minister's determination to restore him to office with indecent haste. Although Margaret Thatcher thought her government was weaker without Cecil Parkinson, her caution dictated that she wait nearly four years before recalling him after an acrimonious and highly publicised extra-marital affair had forced his resignation in 1983. Even though Mr Parkinson was a particular favourite, Mrs Thatcher believed that dust had to be allowed to settle and memories to fade.

Mr Blair seems neither to have learnt from that nor, more surprisingly, from the experience of

bringing Peter Mandelson back into the cabinet within ten months of his first resignation over an undisclosed loan. The speed of Mr Mandelson's return contributed to the vulnerability that made it impossible for him to survive a later and, as it turned out, unfounded allegation that he lobbied another minister to approve the citizenship application of a rich donor to the ill-fated Millennium Dome.

With Mr Mandelson, the prime minister was prepared to take the risk because of his special value. The same applies to Mr Blunkett, who is one of the few ministers he trusts to get things done. Mr Blair not only admires his ability to dominate a department through sheer force of personality, but also values his working-class authenticity and unashamedly populist instincts.

Welfare reform is one of those areas in which Mr Blair now wishes he had gone further and faster, and he is relying on Mr Blunkett to make up for some of the lost time. Next month's green paper is meant to show how the government intends to deal with something it has discussed for years, but not done much about—the scandal of an incapacity-benefit (IB) system that perversely incentivises recipients to remove themselves permanently from the labour market.

According to some estimates, little more than a third of the 2.7m who receive the benefit have medical conditions so severe that work of any kind is beyond them. There are 160,000 recipients under 25—a 60% increase since Labour came to office in 1997. The proportion of the working-age population in Britain on IB is more than double the number that receive similar benefits in comparable European countries.

Mr Blunkett argues (as did his predecessors) that this is not just a waste of money, but also a tragic waste of human potential. However, when Labour last tried modest reform six years ago, 67 MPs rebelled, cheered on by demonstrators in wheelchairs. Mr Blunkett says he wants to bring forward new legislation as soon as people have had a chance to comment on the green paper. But with Labour's majority down to 66, he also knows he will have to do rather more persuading than he was used to when he was in his pomp at the Home Office.

Nobody has a better moral claim to make the case for radical reform of IB than Mr Blunkett does. But apart from setting out eight rather bland and uncontentious “principles of welfare reform” last week, he has been unusually quiet of late. There is speculation that the personal battering he has taken combined with the arcane complexities of the subject have sapped his once-bullish confidence and reforming zeal.

Bloody and a bit bowed

Not even Mr Blair can be certain what effect the continuing attention on Mr Blunkett's not-so-private life will have on his ability to do his job. Friends speak of his resilience and impressive ability to compartmentalise (the same was said of Bill Clinton during the Monica Lewinsky business). They also claim that the level of persecution is such that there is a new mood of sympathy for him and some recognition that the scrapes he has got himself into are the consequence of a loneliness exacerbated by his phenomenal professional achievement.

Against that, with the admittedly important exception of the prime minister, Mr Blunkett is short of political friends these days. The rather posh women he has got himself mixed up with have awakened usually dormant class prejudices in the Labour Party, while cabinet colleagues have forgiven, but not forgotten, the gratuitous attacks Mr Blunkett made on them in the pages of a recent biography. Mr Blunkett also made many enemies during his time at the Home Office thanks to his cavalier approach to civil liberties and the war of attrition he waged against the judiciary. His reception at last month's Labour conference was noticeably cooler than in previous years.

If Mr Blunkett decides he has had enough controversy to last him some time, few would be surprised. But only by doing something big and brave can he show that he is still in business as a major political figure. We will soon know which it is.

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A market for ideas

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Intellectual-property protection can be good for the technology industry as well as for its customers, says Kenneth Cukier (interviewed here). But it requires careful handling

"The granting [of] patents 'inflames cupidity', excites fraud, stimulates men to run after schemes that may enable them to levy a tax on the public, begets disputes and quarrels betwixt inventors, provokes endless lawsuits...The principle of the law from which such consequences flow cannot be just."

The Economist may have put it rather strongly in 1851, but its disapproval of patents represented conventional wisdom at the time. A century earlier, Adam Smith had described them as necessary evils, to be handed out sparingly, and many other economists have since echoed his reservations. Patents amount to temporary monopolies on useful new inventions.

In recent years intellectual property has received a lot more attention because ideas and innovations have become the most important resource, replacing land, energy and raw materials. As much as three-quarters of the value of publicly traded companies in America comes from intangible assets, up from around 40% in the early 1980s. "The economic product of the United States", says Alan Greenspan, the chairman of America's Federal Reserve, has become "predominantly conceptual". Intellectual property forms part of those conceptual assets.

In information technology and telecoms in particular, the role of intellectual property has changed radically. What used to be the preserve of corporate lawyers and engineers in R&D labs has been speedily embraced by the boardroom. "Intellectual-asset management" now figures as a strategic business issue. In America alone, technology licensing revenue accounts for an estimated $45 billion annually; worldwide, the figure is around $100 billion and growing fast.

Technology firms are seeking more patents, expanding their scope, licensing more, litigating more and overhauling their business models around intellectual property. Yet paradoxically, as some

companies batten down the hatches, other firms have found ways of making money by opening up their treasure-chest of innovation and sharing it with others. The rise of open-source software is just one example. And a new breed of companies has appeared on the periphery of today's tech firms, acting as intellectual-property intermediaries and creating a market for ideas.

Mind the keep-out signs

At the same time, however, the legitimacy of many patents granted is in question as patent offices struggle with the huge increase in demand. Over the past decade the number of patent applications has nearly doubled and continues to climb. Much of that growth has been in the IT and telecoms field: in America alone, that sector's overall share of patents has increased from around 30% in 1990 to almost 40% today. Also climbing, alas, is the number of lawsuits over patent infringement, the cost of litigation, and the amount of money plaintiffs are winning.

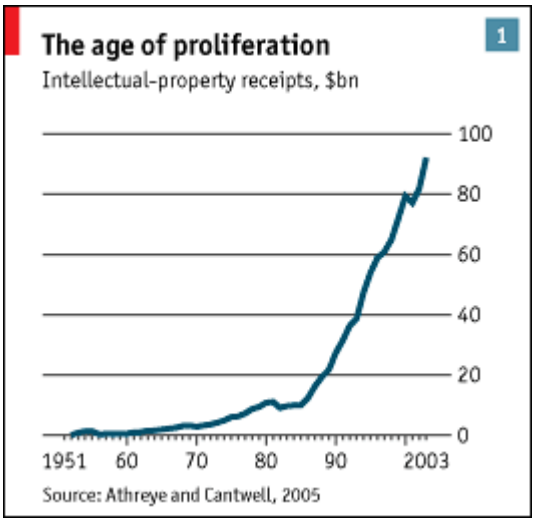
Meanwhile, emerging technology powerhouses such as China and India are competing to move up from lower-end work such as hardware manufacturing and software coding to more sophisticated projects requiring their own innovation. This could pose serious challenges to today's incumbents. The number of patents granted at China's patent office has trebled in the past four years alone.

“Intellectual property has become more central to the industry,” says Greg Papadopoulos, chief technology officer of Sun Microsystems. “I don't know if that is a function of a mature industry, or simply a confused one.”

Licensed to make money

The facts and figures speak for themselves. IBM alone now earns over $1 billion annually from its intellectual-property portfolio. HP's revenue from licensing has quadrupled in less than three years, to over $200m this year. Microsoft is on course to file 3,000 patents this year, when in 1990 it received a mere five. Earlier this year it set up an entirely new corporate division to exchange its technology for cash or equity in start-up firms. Nokia has recently started licensing its technology to other firms and plans to do more. And some companies, such as ARM, a British firm that designs the blueprints for microchips used in wireless devices, do little other than create and sell intellectual property.

According to a survey of business executives last year by McKinsey, a consultancy, 54% of companies saw growth in licensing of 10-50% between 2000 and 2002. Almost 75% of executives say they expect to buy as well as sell more licences over the next two to five years, and 43% expect a dramatic increase in their licensing revenue. And they think the market is still embryonic. “Many companies generate a lot of intellectual property and do not capture the value from it,” says Jay Jubas of McKinsey.



The new predominance of intellectual property in technology industries is fed by a number of broader industry trends. First, IT and telecoms have become so complex that there is a greater willingness to accept the innovations of others. Gone are the days when vertically integrated firms handled every step of a product, from initial design to final sale. Now, a small army of specialist

firms focus on narrow portions of technology, using intellectual-property rights to protect their inventions when they are licensed out.

Second, as many new technologies quickly turn into commodities, firms increasingly rely on innovation to remain competitive. Yet the return on investment in R&D is short-lived because more people innovate at a far faster pace than before. That means margins have shrivelled, explains Ragu Gurumurthy of Adventis, an IT and telecoms consultancy. “How to recoup the cost of innovation? By licensing the technology,” he says.

Third, customers are demanding “interoperability” and common standards rather than proprietary systems, which means different firms' technologies must work together smoothly. This often requires pooling patents or cross-licensing agreements.

Fourth, generating intellectual property is less capital-intensive than other aspects of the IT businesses because it relies mainly on people rather than bricks, mortar and machinery. That makes it attractive to many start-up firms. Venture capitalists often demand that firms patent technology, both to block rivals and to have assets to sell in case the firm flounders. This was particularly apparent during the internet boom in 2000. “In addition to the dotcom bubble, we had a patent bubble,” says Mark Webbink of Red Hat, a firm that sells Linux, an open-source operating system.

Companies cannot simply turn their back on what is happening in intellectual property. Even if they refuse to play the game, they may be unwittingly infringing someone else's patents because there are so many more of them around. Unless firms have patents of their own to assert so they can reach a cross-licensing agreement (often with money changing hands too), they will be in trouble. Thus many companies are acquiring large numbers of patents for purely defensive reasons, for use only to keep others' patent threats at bay.

Legally, the intellectual-property system covers four areas: copyrights (used to protect artistic, musical or literary works); trademarks (for things like brands); patents (for inventions); and an ill-defined category of “trade secrets”, for practices that are kept confidential. The system provides legal protection against counterfeiters and copiers and is vital to many fields, such as biotechnology and nanotechnology. And it matters not only to companies: universities, too, have recently become big patent holders and licensers.

In IT and telecoms, the area of intellectual property that is creating particular upheaval is patents (see article). This is because patents confer a “negative right” to exclude others from using the same technique; yet information technology and telecommunications rely on “network effects”, meaning that as more people use a system, it becomes that much more useful. To make the most of such network effects, interoperability between different technologies is essential. This can be achieved either by a single standard set by a dominant firm (which tends to generate resistance from customers and competitors), or by using a mixture of different technologies, with the patent system providing legal protection for inventions.

The more the merrier

As the system of intellectual property evolves, the ethos seems to be that if a little is good, then more is better. That is to say, if some property rights on inventions are beneficial, then increasing those rights—in scope, strength or duration—will increase the benefits. But that is a large assumption. There is even a body of evidence to suggest it is flatly wrong.

The technology industry faces the question of whether today's abundance of patents, rather than lubricating the gears of innovation, may be clogging them up. Already, businesses are having to

negotiate with other firms in order to do basic things such as reading files from different proprietary formats; and the design of new technology products now involves lawyers as well as engineers. The proliferation of patents might prove a serious encumbrance to businesses, just as travellers along the Rhine in medieval Europe were slowed down by having to pay a toll at every castle.

James Boyle, a legal scholar at Duke Law School in North Carolina, claims that the current increase in intellectual-property rights represents nothing less than a second “enclosure movement”. In the first enclosures, in 18th- and 19th-century Britain, the commons—open fields used by many, belonging to all, owned by none—were fenced in, and nearly all land became private property. By analogy, the granting of property rights on ideas, to the extent it is happening today, is plundering the intellectual commons of our public domain.

Others see the expansion of intellectual-property rights as hugely beneficial, leading not only to more innovation but to more openness. The standard justification for the patent system is that it provides an incentive for innovation, allowing the inventor to reap rewards by protecting the work from imitators who would otherwise hitch a free ride on the investment. But that is a simplification. The initial intention was in fact to make inventions available to the public as well.

Before the 18th century, innovations were mainly kept secret through trade guilds. Sometimes monarchs capriciously granted indefinite exclusive rights to someone they favoured. Intellectual-property law was meant to remedy this by requiring the invention to be vetted by experts, limiting the right to a set period and making knowledge more widely accessible through public disclosure. Its development was part of the drive towards democracy and capitalism and the abolition of royal privileges and monopolies.

In principle, patents open up innovations in two ways. First, they confer only temporary rights; once patents expire or are abandoned, the intellectual property they are designed to protect passes into the public domain. Second, they require the details of the invention to be disclosed so they can be replicated. This permits follow-on innovation, which is essential for industrial progress.

More recently, as the patent system has evolved, it has been seen to provide other benefits. It leads to a degree of economic specialisation that makes business more efficient. Patents are transferable assets, and by the early 20th century they had made it possible to separate the person who makes an invention from the one who commercialises it. This recognised the fact that someone who is good at coming up with ideas is not necessarily the best person to bring those ideas to market.

Such specialisation is now so common that it is taken for granted. Semiconductors, the silicon chips that power digital devices, are typically designed by specialist firms that are good at engineering, but physically produced by other firms whose expertise lies in manufacturing. As the patent system has matured and licensing has become much more widespread, these transfers are turning business relationships on their head. Some economists argue that the growth of patent transactions is establishing a proper “market for technology”. The creation of any market takes time and trouble. When such an institution develops, those outside the system feel threatened by it and condemn it. Yet just as the banking system created a market for capital and the insurance industry created a market for risk, the growth of the patent system may be creating a market for innovation.

This provides a sort of “liquidity” to knowledge that did not previously exist, argue Ashish Arora, Andrea Fosfuri and Alfonso Gambardella in their 2001 book, “Markets for Technology, the Economics of Innovation and Corporate Strategy”. Seen that way, the evolution of the patent system in IT and telecoms is simply part of a broader movement to create an institutional mechanism for the transfer of ideas to fuel economic progress.

Mutually assured destruction

That is the context in which commercial battles are taking place in the technology industry today. The convergence of IT and telecoms is forcing companies to work together in new ways in order both to protect and exchange their technology. “How do you create a marketplace for ideas in that converged marketplace?” asks David Kaefer, director of intellectual-property licensing at Microsoft. “That is really the big question. In the past, two parties would haggle over a pound of wheat. Today, they haggle over the patent of the week.”

These markets for technology are expanding. For instance, 60% of technology and telecoms firms report an increase in licensing compared with the previous decade, and 70% report fewer obstacles to reaching such agreements, according to a survey by the Organisation for Economic Co-operation and Development in 2004. “Intellectual property is the next asset class. Companies are creating a market,” says Eric Gillespie, the co-founder of ipIQ, one of the new crop of firms that are fuelling patent transactions.

But when talking to executives in the technology firms themselves, the language you hear most often is that of “the arms race” and “mutually assured destruction”. Companies amass patents as much to defend themselves against attacks by their competitors as to protect their inventions. Many technology companies have recently championed reform of the patent system to deal with spuriously awarded patents, licensing extortion and massive lawsuits. “There is a broad recognition in the US that the patent system, if not reformed, will...begin to impede American competitiveness around the world,” says Bruce Sewell, general counsel of Intel, the world's biggest chipmaker.

This survey will argue that, despite such adjustment problems, the huge changes in intellectual property currently taking place in the IT sector will in time produce more efficient markets. But what do the IT firms themselves make of it all?

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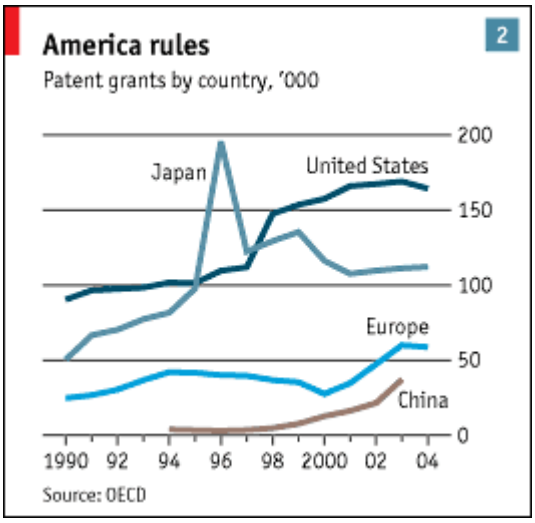
Patent sense

Oct 20th 2005
From The Economist print edition

How the system works

THE first modern patent law was introduced in Venice in 1474 to attract skilled merchants to the city-state. Anyone who came up with a technique deemed novel was given a ten-year right to its exclusive use; infringers were fined 100 ducats.



These days, patents are granted on a national basis after close scrutiny by government patent offices. The laws differ in detail, but the main points are similar (thanks to intergovernmental treaties). Generally, the technology to be patented must pass four tests: that it is novel, useful, non-obvious and man-made. A mere discovery of a natural phenomenon would not qualify. A patent confers the right to exclude others from using an invention for around 20 years.

Patents are enforceable only in the jurisdiction that grants them, so a patent awarded in America, for instance, is valid only in that country. But as the country with the world's largest economy, America in some respects acts as the world's patent office; around half of all patents there are awarded to foreign applicants. The cost of applying for a patent in America is around $2,000, but the legal fees for preparing it can easily run to $35,000. Applicants also have to find around $7,000 in renewal fees. Once the patent has expired, the technology enters the public domain and can be used freely.

The three main patent offices, accounting for nearly 90% of the world's patents, are in America, Europe and Japan. A European patent does not confer the right to enforce it in all EU countries, only those that are requested, and for which an official translation into that language is made. Since patent disputes can hinge on the meaning of a single word, and some applications can be hundreds of pages long, this is a cumbersome rule. Attempts over three decades to establish an EU-wide patent have been blocked because of bickering over what the legal languages should be.

Software was unpatentable until 1981, when an American court changed the rule. Likewise, an American court in 1998 allowed “business methods” to be patented, which brought a torrent of applications. Europe has resisted patents on business methods, and closely scrutinises software patents. A proposed EU directive to harmonise software patents was scuttled in July after protests from open-source advocates.

As time has gone on, the patent system has accumulated a number of problems that will have to be resolved before it can operate effectively. For example, the number of applications has roughly doubled in the past decade, so patent offices are swamped. This means it now takes around three years to decide on an application, which has created a backlog of around 500,000. If nothing is done, that figure will double by 2010.

Experts also claim that the quality of patents—measured by whether the invention is truly new and meets its claims—is deteriorating. This can cause trouble if the holder uses a “junk” patent to extract royalties from others on things that ought be in the public domain. Litigation is already becoming more frequent and more costly.

To improve matters, America is considering legislation that would specify a period after the granting of a patent during which it can be challenged. It would also increase the funding of the patent office to hire more examiners with greater expertise. Controversially, it would bring America in line with most other countries by changing the criterion for a successful application from “first to invent” to “first to file”. Small inventors oppose this, but companies prefer it because it provides greater legal certainty.

For the longer term, there is talk about harmonising patent policy worldwide, which would be good for global business. Meanwhile, competition regulators have begun taking an interest in patents. They see them as a commercial weapon that could violate antitrust law. Offenders can expect penalties exceeding 100 ducats.

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The arms race

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Companies are preparing for the intellectual-property battle

AS A 23-year-old engineer working for Hewlett-Packard in 1975, Joe Beyers had a clever idea. The new desktop computers, he thought, should be able to work on more than one task a time (something that at that point only much bigger computers could do), rather than forcing users to twiddle their thumbs as they waited for new applications to launch. After many late nights in the lab, he devised a way to make it happen, and duly had a patent granted on his invention—his first of many. Yet within a few years, all computer-makers were using the same technique.

Mr Beyers told Bill Hewlett and Dave Packard, the company's founders, that the idea was being copied, and tried to persuade them to enforce the patent. But both said no; the firm was benefiting from the invention in its own products, and that was enough. “I was disappointed,” says Mr Beyers. “I thought it was a very valuable patent, and HP deserved some value from it. I put it aside and moved on. But in the back of my mind, I felt that we had not done enough to get the full value of it.”

Times change, and so did Mr Beyers's role in the company. Thirty years on, he now manages a team of 50 people in HP's intellectual-property division. When he meets the boss, it is to report on the group's patenting and licensing business, an area where engineers and lawyers work hand in glove. Since the unit was created in 2002, HP's licensing revenue has increased from $50m to over $200m. “It represents a fairly dramatic shift in how HP treats IP,” Mr Beyers concedes.

The changes at HP are mirrored throughout the technology sector. Companies are now treating intellectual property as a business asset not very different from a product on a shelf. They are spending more on R&D, filing for more patents and licensing out their ideas, as well as licensing in other people's. They are also increasingly asserting their patents against others, demanding

royalties and going to court to get them. “We are in the middle of an explosion in the use of IP to try to protect market positions,” says Intel's Mr Sewell.

The biggest reason for relying more heavily on intellectual property is that other firms are doing the same. Most companies readily admit to the drawbacks. It can make it tougher to build new products without accidentally infringing someone else's patents, as well as increasing costs and sometimes leading to spurious lawsuits. Yet technology executives insist they must harness the system lest they be crushed by it. Pressed on why his company is pushing to obtain more and wider patents, Henning Kagermann, the boss of SAP, a large German software firm, exclaims in exasperation: “These are the rules of the game!”

“There is certainly a level of mutually assured destruction among the big companies. If you build up your patent portfolio, I build up mine—nukes pointing at each other,” says Mr Papadopoulos at Sun Microsystems. But he sees it as an advantage rather than a problem. “That has exactly the right outcome. We sit here and exchange patents with each other. Ultimately, that's great: you have a set of companies doing more innovation than they would have otherwise,” he says.

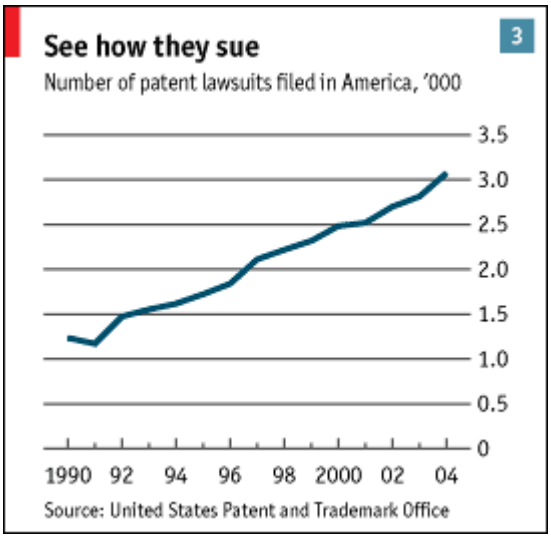
Those inventions increasingly get turned into property rights. For example, Nokia has over 12,000 existing patents globally, and 10,000 innovations in the process of being patented. It files around 1,500 applications a year. IBM has around 40,000 patents and is granted 3,000 more every year, which has made it the number one recipient at America's patent office for the past 12 years. HP last year ranked fourth in America, with 1,783 patents; worldwide, it holds around 25,000. Microsoft has recently sprinted into the market, with around 10,000 applications pending.

Patents have grown in parallel with an increase in spending on research and development. One rule of thumb is that tech companies file almost two patents for every $1m they spend on R&D. The likelihood that research will yield a patent has increased hugely, thanks in good part to the growth in software patents. According to a 2004 study by James Bessen, a researcher at Boston University's School of Law, and Robert Hunt, an economist at the Federal Reserve Bank of Philadelphia, by the end of the 1990s firms were able to obtain more than twice as many software patents for every R&D dollar they spent than at the start of the decade.

Messrs Bessen and Hunt find it worrying that the growth in the number of patents exceeds the increase in R&D expenditure. They believe it indicates that these are “cheap” patents being used as a substitute for more R&D. In other words, the cake is not getting much bigger, it is merely being cut into more and ever thinner slices. Is the industry doing too much patenting merely for the sake of it?

“We have 10,000 patents—it's an awful lot of patents,” says Mr Sewell at Intel. “Would I be happy with 1,000 patents rather then 10,000? Yes, provided the rest of the world did the same thing.” John Kelly, who directs IBM's intellectual-property strategy, explains that: “Even though we have 3,000 patents [awarded annually in America], if we had to, I could make that number 10,000.”

Despite this proliferation, numerous economic studies show that only about 5% of patents end up having any value, and that a small handful of those account for most of the income received from patents. Moreover, according to a study by America's National Bureau for Economic Research in 2000, patents were less effective in protecting innovation than things like secrecy, speed to market and complementary manufacturing, sales or service.



With firms acquiring more patent ammunition each year, what if someone were to pull the trigger? “Should one company use its portfolio against another, it faces potential retaliation. The best that can happen is nothing happens,” says Joe LaSala, general counsel of Novell, a software company that sells proprietary applications along with the open-source Linux operating system.

With the plethora of patents swishing around the system, it is impossible to avoid potential infringement, so self-defence becomes imperative. One former executive at a search-engine company says that all the major search firms—Google, Yahoo! and MSN—actually infringe each other's patents in some way. Their intellectual-property strategies are designed to ensure a balance of power. The same is true in nearly all other areas of IT and telecoms. Everyone has an interest in preserving this precarious equilibrium lest the whole edifice come crashing down.

Pure intellect

Qualcomm is the very model of an intellectual-property company. Where many companies line their walls with pictures of their products, in the firm's San Diego headquarters the corridors are covered with plaques of its patents. Qualcomm created a technology called CDMA, which now forms the basis of third-generation wireless networks. Around one-third of the company's revenues (and 60% of its profits) come from royalties on all equipment that uses the technology; the remainder comes from selling the chips that rely on that intellectual property, where it has a market share of over 80%.

Because its technology underlies the third-generation mobile-phone standard, Qualcomm has become a toll bridge that all equipment-makers must cross. “Our licensees don't like to pay us royalties, but they forget the work we put in to get the business. We provide them with quite a bit more than a patent licence,” explains Steve Altman, Qualcomm's president. “If we were just an IP shop, we would not have been successful. What caused us to be a success was that very early on we didn't just license patents, we enabled the manufacturers to get to market quickly.”

The licensing practice began when Qualcomm was young and struggling in the early 1990s, helping its cashflow. At first, the company made the mobile phones as well as developing the underlying technology, but in 1999 it sold its handset division in order to focus on the less tangible—and more lucrative—part of the business. Today, it spends almost $1 billion a year, or 19% of revenue, on R&D. It has amassed 1,800 patents, and 2,200 applications pending.

“We could have very easily said, ‘Let's close up shop, sit back and wait for royalties to come’. But that would have been a short-lived business: the technology evolves very quickly,” says Mr Altman. In August, Qualcomm paid $600m for Flarion, a firm with little revenue but around 100 patents either issued or pending on a new generation of wireless technology. If all goes as planned, this will allow Qualcomm to dominate the next phase of high-speed mobile communications too.

“IP companies can be very profitable. That doesn't mean we are extortionists by any means. If you get the technology right, you get to license it many times,” explains Tudor Brown of ARM, a British firm that creates the intellectual property behind microchips used in nearly all mobile phones and other wireless devices. ARM is the most ubiquitous company no one has ever heard of, with its technology in use in over 70% of all mobile phones. Whereas Qualcomm still keeps a foothold in the physical world by supplying chips, ARM does nothing but R&D and licensing.

But Mr Tudor has a warning for firms that want to concentrate exclusively on the intellectual-property business: licensing usually works only alongside a basket of products or services. For IBM, for example, the majority of its intellectual-property revenue comes from the sale of know-how, not patent licences alone. In essence, the difference is that between the recipe for a dish and a list of ingredients.

ARM was fortunate to be in the right place at the right time, when numerous chip-design firms all wanted to outsource the basic technology for wireless chips so they could innovate on top of it. Also, ARM understood that it needed to offer a lot more than just patent licences, such as documentation and support for its licensees. “They are successful only if they get it right, and we are here to help them get it right,” Mr Tudor says.

Yet it is easy to get it wrong. Take BT, Britain's telecoms incumbent, which in 2000 announced that it had a patent on hyperlinks, a technology that allows people to click on a web-page link to go to another web address. BT claimed it had developed this innovation more than a decade earlier, before the web even existed. Its executives whispered that it was worth billions. The company sent out menacing letters to firms, seeking to enforce its “rights”. But an American judge laughed its claims out of court.

Mr Beyers at HP says he also gets many demands to pay up for infringing someone else's patents. But he is often able to show that the accusers are themselves infringing HP patents, and occasionally ends up getting them to pay him instead.

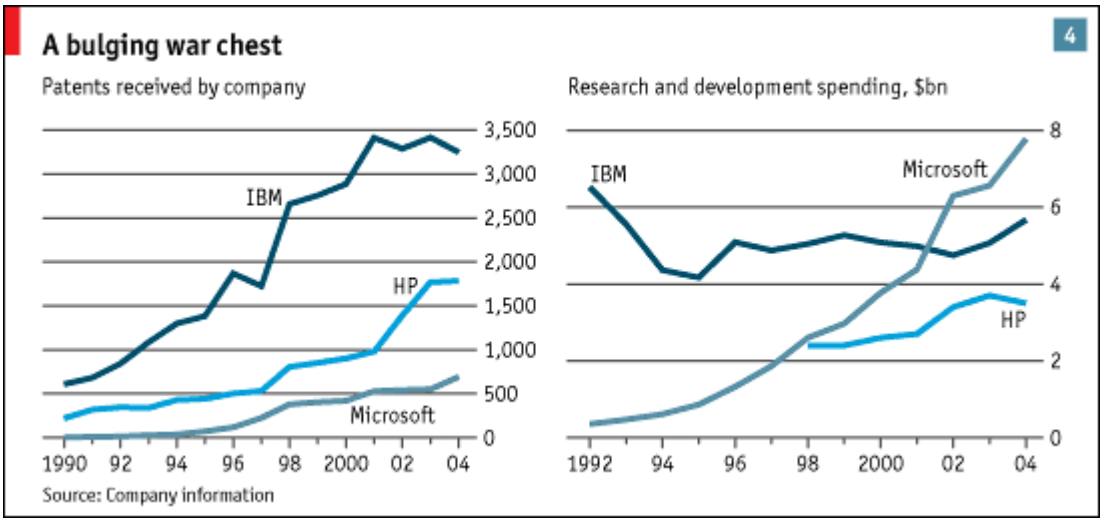
The Microsoft factor

One of the newest entrants to the intellectual-property game is also the most feared: Microsoft. In the past two years, the company has reshaped its entire strategy around innovation and patents. This will have serious consequences for the rest of the industry.

In 2003, Bill Gates, Microsoft's founder and chairman, faced a number of problems that centred around intellectual property. First, the company found it was being sued for patent infringement more often and had to pay hundreds of millions of dollars in damages. Second, antitrust regulators were forcing Microsoft to open its technology to rivals to allow different systems to work together. Third, the company recognised that its monopoly on its operating system and desktop software would be eroded over time, in part by open-source alternatives, and wanted to delay that process. Lastly, Microsoft was spending around $5 billion a year on R&D and wanted some revenue to help offset that outlay.

Mr Gates summoned the father of IT patent licensing, Marshall Phelps, a cheerful lawyer in his 60s

who had recently retired after 28 years with IBM, where he set up and ran the company's highly regarded licensing programme. Mr Phelps told Mr Gates that he had three options: keep the firm's intellectual property within the company to use in its products but make no ancillary revenue from it; assert the company's patents against others (and face the wrath of regulators and rivals); or license it. In June 2003, Mr Gates plucked Mr Phelps out of retirement; by December, Microsoft's intellectual-property licensing division was born.



Since then, in addition to offering technology to other firms, Microsoft has struck a score of cross-licensing deals with big companies. Last May the company started a new business unit, Microsoft Intellectual Property Ventures, to license technology—in areas such as graphics, security and databases—to venture capitalists and start-up firms, sometimes in return for stakes in the companies. That is a new departure: in the past, Microsoft has tried to “cut off the air supply” of rivals, in the celebrated phrase of one Microsoft executive.

Microsoft is coming quite late to the patent game, for the obvious reason that it enjoyed a monopoly in its business area (albeit one judged illegal) for a long time and had little need of patents to protect it. Software copyrights and trade secrets sufficed.

The change in the company's strategy mirrors the wider shifts taking place in the industry as a whole. In 1976, Bill Gates wrote an “open letter to hobbyists”, asking people not to copy the firm's software illegally but to pay for it instead, because that would enable him to fund further improvements in the product. At the time, software was protected by copyright, which automatically comes with any creative work; software patents started to be allowed only in the 1980s, but were rarely sought. When they were first introduced, Mr Gates did not think much of them. In 1991, he wrote in a company-wide memo:

> If people had understood how patents would be granted when most of today's ideas were invented and had taken out patents, the industry would be at a complete standstill today...A future start-up with no patents of its own will be forced to pay whatever price the giants choose to impose.

What changed, explains Mr Kaefer of Microsoft, was the need to make the technology more open to others, to share it and to interconnect with other firms' technology. “Software patents take the place of trade secrets that we relied on before,” he says. “Software is built on the shoulders of giants—no one can build the whole thing. Patents are a property right that allow the innovation to be exchanged.”

However, there is a controversial side to Microsoft's intellectual-property ambitions. Since 2003, the company has claimed patents on some basic aspects of information technology that many computer scientists say are well established already and should be open to all, such as the “file allocation table” system that computers use to manage files. It has also asserted rights over file formats and so-called “application programming interfaces” that let different types of software interact. These things, critics argue, are not truly intellectual property but merely translations to allow interoperability. Moreover, Microsoft has used its recent multi-billion-dollar antitrust settlements with AOL, Sun, Novell and others to strike broad cross-licensing agreements, thus neutralising potential patent foes.

Taken together, Microsoft seems to be preparing to use its intellectual property as a way to demand a sort of “interconnection fee” from competitors so that their software can interact with Microsoft's (in the same way as a dominant telecoms operator uses interconnection to its network to thwart rivals). The company, suggest the critics, is simply trading its illegal monopoly for a legal one.

No wonder that Microsoft is strongly resisting a requirement by the European Union's antitrust regulators to disclose its networking protocols, which enable different software to interact, arguing that it should be compensated for its intellectual property. This, in particular, hurts open-source software developers, who lack the formal corporate structure (and funds) to license the code. This summer Microsoft took the EU to court over the matter.

In fact, the chief challenge to the company comes from open-source software, whose supporters insist that innovations should be shared, not kept proprietary. Mr Gates calls them “new, modern-day sort of communists” who “don't think that those [intellectual-property] incentives should exist.” And Microsoft has trumpeted that it will indemnify its users against potential patent-infringement liability—which is clearly meant to show up open-source software, where some infringement cases have been brought.

All in all, it looks as though Microsoft is preparing to use intellectual property as a new competitive weapon. Last year, Mr Gates told financial analysts that the firm would increase its patent filings to around 3,000 in 2005, up from 2,000 the year before and the low hundreds in the 1990s. The company currently holds over 6,000 patents, and has around 10,000 applications pending.

At the same time, Microsoft is among the companies most frequently sued for patent infringement: it is currently involved in 32 patent disputes, and spends close to $100m a year in legal costs. Conversely, in the area of copyright, Microsoft's software is the most pirated in the world, causing billions of dollars of potentially lost sales each year.

Industry-wide, there is a danger that big technology firms' infatuation with intellectual property may cause them to exploit their dominant role, forcing smaller firms to pay up or go under. If that happened, only the biggest companies with stacks of patents could hope to survive comfortably. Smaller companies would have to start taking out ever more patents to defend their interests.

To critics of the patent system, this is a sign that the pendulum has swung too far in favour of intellectual-property owners, resulting in an inefficient market for technology. There have been calls for legal reforms and changes in business culture in favour of a more balanced and open approach. But in fact these changes are already taking place—and the impetus is coming not from policymakers or lawyers, but from within the technology industry and from the marketplace itself.

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Voracious venture

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From The Economist print edition

A new intellectual-property business model

WHEN visitors walk into the headquarters of Intellectual Ventures, they come face to face with the full-size head of a *Tyrannosaurus rex*—the special-effects model used in the film “Jurassic Park II”. Is that a hint that the company wants to eat IT companies alive?

Nathan Myhrvold, its founder, thinks not. He is excited about the company's strategy, which he describes as “an experiment”. Intellectual Ventures represents a radically new business model for technology—a cross between a venture-capital fund, a law firm and an R&D lab. It wants to finance inventors to do what they do best—invent—and obtain patents on those technologies. Then it wants to license those innovations to the world (and pursue infringers with razor-fanged determination). The IT industry is terrified of it.

The main reason to take Intellectual Ventures seriously is Mr Myhrvold himself. After selling his software company to Microsoft in 1986, he spent the next 14 years as the company's top techie. He is naturally brainy, entering university at 14 and getting a doctorate at 23, then doing physics with Stephen Hawking at Cambridge. He left Microsoft worth hundreds of millions of dollars, and turned his talents to promoting innovation (as well as funding dinosaur excavations).

In his view, the world has an archaic idea of patents: that they are worth something only when they come with a product. It reminds him of the businessmen in the 1980s who insisted there was no money in software because people would buy only something they could see, ie, the computer itself.

His business model for his new venture is precisely the same as the one he got to know at Microsoft: come up with a technology so pervasive that no one can avoid paying for it. The difference is that Microsoft tried to operate a monopoly the government sought to make illegal; Intellectual Ventures proposes to make use of the government-granted legal monopoly conferred by a patent.

Intellectual Ventures expects shortly to be granted its first patent, related to digital imaging, and has hundreds of applications pending. But in the meantime the company has been delving into its huge bank account—rumoured to exceed $300m, from backers that include Microsoft, Nokia and Sony—to purchase heaps of patents up for sale. It has not asserted any patents yet, but many think it is just circling before devouring its prey.

Trolling for business

There have recently been complaints in the industry about “patent trolls”—patent holders that send letters asking IT companies either to pay royalties or face a long, costly lawsuit. Is Mr Myhrvold not the biggest troll of all? He smiles at the question. By funding invention only, he says, even with the cost of licensing it, his firm will provide society with more innovations than it would otherwise have had. In that sense, Intellectual Ventures may be creating a market for inventions

that marks a new phase of capitalism. Already a gaggle of firms with fancy names such as iPotential, ipValue, Yet2.com and ThinkFire are making a business of patent transactions, and hedge funds are acquiring patent portfolios.One day, Mr Myhrvold says, the dichotomy between physical products and intellectual property will become extinct.

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An open secret

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From The Economist print edition

Sharing intellectual property can be more profitable than keeping it to yourself

ON JANUARY 11th this year, America's patent office reported that IBM had earned the top spot in its annual patent ranking for the 12th time in succession, earning 3,248 patents in 2004. On the same day, at the firm's headquarters in Armonk, New York, IBM did something unusual: it pledged 500 of its existing software patents to the open-source community, to be placed into a patent "commons" that allows open-source software developers to use the innovations and build upon them without risk of infringement. Why would a firm that cares so much about intellectual property want to give it away?

"It isn't because we are nice guys," explains Mr Kelly, the head of the company's intellectual-property division. The company's motive, he says, is fear that patent rights have swung so far towards protection that they risk undermining innovation. The patent commons is meant to help restore the balance. "If this balance goes too far in one direction or another, this industry will not survive and our company will not survive. It is really that fundamental to us," Mr Kelly says.

Since then, some other companies have taken similar initiatives. In May, Nokia said it would not assert its patents against the inner code of Linux, a popular open-source computer operating system. In June, Red Hat, a big Linux distributor, said that it, too, would contribute to a patent commons. In September, Computer Associates donated 14 patents for free use by the open-source community. Open Source Development Labs, an industry forum, has offered to act as a repository for patent-commons projects.

Even Sun Microsystems, for years the epitome of a proprietary company, with specially designed semiconductors and software that work on its machines, announced a change in approach. Threatened by the pincer movement of commodity computer chips inside machines and Linux software running on them, it made its Solaris operating system open-source.

The trend towards open software code is an example of a bigger development in the technology industry: a new approach towards collaboration and “open innovation” that at times seems to work around the traditional intellectual-property system, and at times is directly fostered by it. “People think this is all a sort of flaky, radical, pinko strategy not related to the competitive marketplace. *Au contraire*! This is about how to kill your competitor,” says Don Tapscott, a management expert who studies innovation. “And you kill your competitor these days by identifying the need to innovate yourself, but also opening up that innovation; by owning IP, but also sharing IP.”

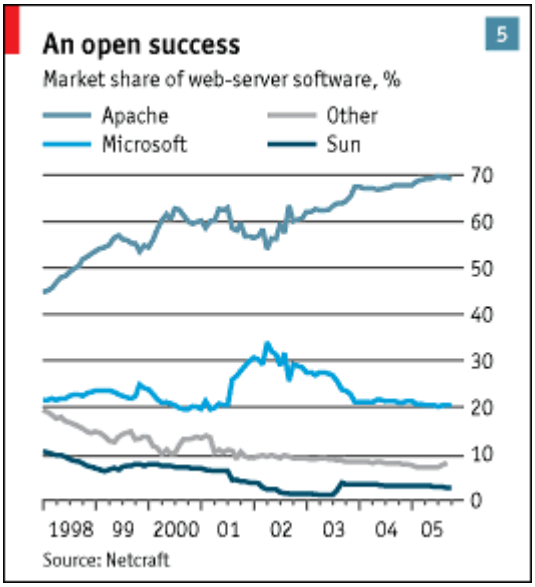
Sprats and mackerels

How do IBM, Sun and others make money on open-source? The answer varies from company to company, but has to do with standards, interfaces and something the techies call “ecosystems” (that is, a community of third-party developers and service businesses that contribute to, and enhance the value of, the underlying product). “Instead of having a closed proprietary system, this is a way of opening the development environment to a larger community,” says Auli Luukkanen-Lääperi, who heads Nokia's intellectual-property strategy. She says this benefits the company's R&D efforts and translates into more sales, because the firm's mobile phones become more useful to customers.

IBM profits from open-source (and particularly Linux) in two ways. First, open-source software is by some measures less expensive than proprietary software, so using it lowers the overall cost a customer pays for IBM's computers, applications or services. Second, it provides a common platform on top of which IBM can build and sell special applications and services.

Because open-source is non-proprietary, customers are much less locked into the firm supplying the IT systems. Its interfaces are open. Software interfaces are the digital equivalent of plugs and sockets. They require little intellectual endeavour, but are treated as intellectual property to keep rivals out. Opening up an interface means new software can easily be written to plug into it, increasing its value to users.

By giving up proprietary lock-in, firms can reap the advantages of open-source that accrue not just to one company but to all firms industry-wide. They can sell software that works on Linux, and they can count on a far wider ecosystem of developers and service companies to improve the software that benefits both them and their customers. For example, Apache, an open-source application, dominates the market for web-server software.



For Sun, opening Solaris was a way to attract independent developers to the platform, which opens it up to innovation from a broader community. Without this sort of ecosystem, the firm itself would be responsible for all enhancements to the product. That would make it not only slower and more costly but probably also less innovative than Linux, with which it competes in certain areas.

The best analogy is the internet. As late as the mid-1990s, a number of different networking standards were vying to become the world's infrastructure for data communications. One, called X.25, was used by most telecoms operators and many businesses, including France Telecom with

its 9m Minitel terminals. The internet won out because its underlying standards are open and non-proprietary. This kept the cost low, made the system open to improvements and attracted a large development community. And once it was established, it benefited from network effects: the more people that use it, the more valuable it becomes to everyone, and the more others want to use it too.

The internet's ecosystem includes everyone from Cisco and Dell to eBay and Amazon. For instance, Cisco, which makes communications equipment, forgoes royalties on the use of any patent that relates to an industry standard, so as to foster the industry's overall growth, explains Mark Chandler, its general counsel. In return, it hopes to get more sales. Firms such as Cisco, Juniper, Alcatel and others can compete and innovate on top of the internet's open standards, just as two companies making toasters can compete in myriad ways but not on the size of the electrical plug or the voltage, which are based on well-established interfaces and standards.

Open-source software takes a novel approach to intellectual property. Although much is made of it being “free”, in fact it relies heavily on intellectual-property rights, but through copyright and strict licensing terms. The terms generally stipulate that any improvements must be made available to all—though there is no reliable way to enforce this, other than fostering the right kind of culture.

The patent system can be deadly to open-source. It could even block techniques that try to work around a patent, making users legally liable if they use open-source. Indeed, this is precisely why big IT firms are pledging their patents to the open-source community. It is to provide open-source developers with a war chest to fend off patent disputes, by giving them rights of their own to assert (though nobody is sure whether this will work).

Free as a bird

Some members of the open-source community are vehemently opposed to the current system of intellectual property. This movement traces its origins to Richard Stallman, a software engineer who in the 1980s championed a concept called “copyleft”, in protest at the copyrighting of software. He believes software should be as free to use as the Bible, and free to modify, too. This does not mean it should necessarily come without a cost—“free as in free speech, not free beer,” Mr Stallman is fond of saying—but it should be open to developers to tinker with.

Today, a small army of activists is carrying the torch, with names such as Electronic Frontier Foundation, Creative Commons, IP Watch, Public Patent Foundation, Centre for the Public Domain, the Open Knowledge Foundation and the Foundation for a Free Information Infrastructure, which was instrumental in blocking a European Union directive to harmonise software-patent policy this summer.

But the companies that sell open-source software have a different take. “We don't subscribe to the view of some of our friends in the open-source world that IP is bad and hamstrings innovation. The patent system is very necessary,” explains Mr LaSala of Novell, a large Linux distributor that sells its own proprietary software riding on top of the operating system. Still, the company is well aware of the problem: last December Novell paid over $15m to buy a handful of important e-commerce patents in a dotcom bankruptcy auction, simply to make certain that they are not used against the firm or indeed the industry at large.

For some proprietary technology companies, on the other hand, open-source poses a serious threat. Sun, for instance, essentially opened up to save its business, and the outcome remains uncertain. Novell realised that its long-standing proprietary applications would be more valuable atop Linux, so it overhauled its strategy around open-source.

But the biggest threat posed by open-source is to Microsoft. That company has been successful not only because its software is on almost every personal computer in the world, but also because it has brilliantly nurtured a vast community of developers who write applications on top of the firm's Windows platform. This ecosystem enhances its value. Open-source is offering an alternative, common platform for developers to write applications.

Microsoft has responded with a two-pronged strategy. First, it tries to block open-source by using intellectual property. It refuses to license its “protocols,” the interfaces that let open-source products interact with Microsoft; it suggests that open-source software may violate patents and copyrights; and it makes sure everyone knows that its own products, being from a single, known supplier, are entirely above suspicion. Second, Microsoft has adopted some open-source practices, disclosing its source code to large customers. It also opens the programming code of operating systems in which it does not have a dominant position (such as for hand-held devices) to third-party developers.

Let's do it together

Open-source software is not just a new way of treating intellectual property in the IT industry, but a new way of working together as well. Among its most distinctive traits, says Mark Blaxill of the Boston Consulting Group, is its decentralised form of collaboration. It breaks complex tasks down into modular bits, which are worked on by specialists through a clever form of self-organisation (made possible by the internet), and are then reassembled.

Steven Weber, a political scientist at Berkeley and author of “The Success of Open Source”, published last year, thinks this form of economic production has a promising future. The rise of open-source is coming at a time when companies are already managing their intellectual property in ways that are more amenable to sharing than they used to be.

One reason is growing complexity. As firms add more features to their products to keep them competitive, they often need to make use of innovations developed by other companies. And as different companies need to make their IT systems work together to take part in global supply chains, the different kinds of software they are using have to interact seamlessly.

Another reason is convergence. When France Telecom decided to work on multimedia applications with a view to offering television over phone lines, Microsoft was interested too, because it wanted to understand the needs of that market. In May the two firms announced they would develop products jointly and share the intellectual property they would create.

A third reason is the disaggregation into niche firms at the leading edge of the IT sector, and a specialisation that is economically efficient. As this happens, software and components are becoming more modular and interchangeable.

“You see people innovating and creating new ideas and technologies, but not taking them all the way through to the market. They carry it to a certain stage and then hand the baton on to others who bring it on to commercialisation,” says Henry Chesbrough of the Haas School of Business at the University of California, Berkeley. “The patent system is key to engaging in this kind of

innovative division of labour."

This explains the paradox that as today's technology firms acquire more rights to exclude others, in the form of patents, they also feel a greater need to share. They are not doing this for philanthropic reasons, but because intellectual property is so fundamental to their business. As Mr Kelly of IBM puts it: "IP will still be the cornerstone of the successful companies in our industry." Many more patent pledges, he says, are on the way.

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Thinking for themselves

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India and China aim to challenge western tech firms through innovation, not just cheap labour

ON THE sixth floor of the sleek headquarters of Sasken Communication Technologies in Bangalore, India, a small cubicle serves as an office for the chief executive, Rajiv Mody. There, hanging on a wall beside a photograph of Mahatma Gandhi, is a plaque of patent number 5,072,402, for a "Routing System and Method for Integrated Circuits", granted to Mr Mody by America's patent office.

Sasken, a publicly traded firm with $55m in revenue and over 2,400 employees, writes the code that is embedded deep inside the hardware of telecoms equipment, from mobile phones to high-speed internet modems. The patent on the wall is a visible sign that the company, like India itself, is trying to shift from low-end work to more sophisticated technologies, complete with home-grown inventions. The same thing is happening in China. And both countries are using the intellectual-property system to stake out their turf.

For the moment, both are better known as places where intellectual property needs special protection. As a strategy for economic development, nabbing someone else's patents is nothing new. Immediately after America's declaration of independence, its government made it official policy to steal inventions from Europe, expediting the country's rise as an industrial power in the 19th century, notes Doron Ben-Atar of Fordham University in New York. Yet in India and China, the pressure for respecting intellectual property more is now beginning to come from domestic businesses.

It will be a long, uncomfortable process, but again there are precedents. Japan, Taiwan and South Korea, which started off by competing mainly on cheap labour, ended up challenging the West's biggest technology companies. Taiwan now makes the vast majority of the world's computer components, and its companies own a plethora of patents. South Korea's Samsung became one of the top ten recipients of patents granted by America's patent office in the 1990s, and still is. Japan earns the largest number of patents at the same office after America itself (although this is partly because Japanese firms traditionally file large numbers of patents with very narrow claims).

The rise of China and India has mainly been underwritten by foreign companies, not indigenous ones, though this is starting to change. Both countries have been good at persuading firms setting up operations there to invest in training locals. Today, nearly all the large IT firms have big research centres in both countries, and local companies understand the need to develop their own

intellectual property. Local people who went to Silicon Valley to find fortune are now starting up their own businesses in their home countries. Foreign venture capital is pouring in.

Without home-grown technology, India and China have to depend on foreign firms, and they do not like it. China, in particular, has seen a surge in the royalties it is paying to foreign firms, and is trying to stem the flow. When Qualcomm's boss went to China in 2001 to negotiate royalty payments for his company's third-generation mobile-phone standard, he agreed to accept less than what he charges others. Within a year, China was working on developing its own 3G wireless standard. If it succeeds, Qualcomm will see its royalties shrink further.

China and India have more to offer than just low costs, although these are clearly important. They are also able to deploy huge numbers of people to work on a project. Being able to throw bodies at a problem is vital in IT. It allows firms to do things such as speed up development cycles or explore alternative approaches that would not be possible with a smaller labour force.

In short, China and India are not simply taking over western IT jobs, they are changing the very process of IT development. It is not about doing the same thing cheaper, but about doing things that simply could not be done before. In that endeavour, intellectual property is becoming increasingly important.

There are limits to the optimism about India and China. Both countries have a culture of keeping technology to themselves. The western concept of patents is fairly new to them, and has proved controversial for countries at their stage of development. Also, both nations have huge institutional and infrastructure obstacles to overcome. Capital markets are embryonic. Big companies are coddled by the state. India's government bureaucracy is stifling; China's is opaque and corrupt. The legal system is uneven in India and consistently inadequate in China. Both countries badly need more experienced managers.

American technology executives with some experience of India and China are worried that the two are about to eat the rich world's lunch, but locals with deep knowledge of both countries think it will take at least a decade. Still, the overall trend is clear: the rise of China and India as centres of innovation will radically shake up the technology industry that is today based mainly in rich countries.

In 1905, the first light bulb in India was switched on in Bangalore. A century later, the city's technology industry still relies largely on innovation from elsewhere. The basis of the Indian IT miracle is software services. Indian firms hire thousands of software developers to work on behalf of mainly western clients attracted by the low costs. The average annual salary of a mid-level engineer in India is around $12,000 (rising by about 10% a year), compared with five or six times as much in the West. These service companies are doing increasingly sophisticated work as their clients come to trust them more. Besides, western firms are under so much competitive pressure that they have no choice but to do more outsourcing.

Inside job

A handful of small companies such as Sasken, Ittiam, i-flex and others are trying to break the mould of IT services and develop their own patents to license to others. However, whereas big technology companies in America and Europe are increasingly relying on intellectual property to provide streams of revenue, the large Indian software firms tend to hold on to their innovations for competitive advantage rather than open them up for licensing. This is partly because many of their innovations are in processes rather than in products. Their inventiveness is monetised in work done for clients, not as an income source in its own right.

One example is Infosys, a large IT-services firm. As part of a project for a large aerospace company, Infosys had to calculate and optimise a number of attributes of a part, a task that was expected to take around 30 days. Pressed for time, some of the engineers invented a tool to automate the process which cut the period to only four days. But rather than seek a patent or license it out, they are keeping the process secret for their own and their customers' benefit.

Other Indian IT-services companies have similar innovations. Wipro, another large firm, calls them “IP blocks”—reusable bits of software or processes that it can draw on to serve its clients better. The company has around 10,000 engineers working on higher-end design and development for big global technology firms, but a handful of bright people are assigned to working on Wipro's own R&D, not billable to clients. In a computer lab on its sprawling corporate campus in Bangalore, two twenty-something engineers proudly display the green and gold circuit board for a mobile phone they have designed, which runs the open-source Linux operating system. By developing the technology in-house, they can use the expertise thus acquired for many contracts, lowering the cost for everyone.

Wipro holds title to “four or five” patents—none of its executives is exactly sure how many. Yet they all happily report that last year it filed 28 innovation disclosures on behalf of clients, which is the first step towards those companies filing for patents. Wipro does not want to compete with its clients, and does not want to license patents to others.

At Infosys, it is a similar story. The firm filed for two American patents jointly with its clients. But like all things in modern India, this is changing fast. Infosys has seven applications pending at America's patent office, all filed in the past three years. Intellectual property is becoming more important because the IT work the firm is doing is becoming increasingly sophisticated, says “Kris” Gopalakrishnan, the chief operating officer.

One reason why big Indian firms have been slow to embrace intellectual property is the distinction they draw between services companies and product companies. As services companies, they fear that claiming patents would upset their clients, who might treat them as rivals and take their business elsewhere. “India does not have a software industry, it has a services industry,” says one executive. “We do more D than R,” confides another top manager about his company's research and development. Yet in modern IT the distinction seems artificial, particularly when it comes to intellectual property, which is intangible like a service yet increasingly sold as a product.

A raft of small start-ups may be more prepared to go down the intellectual-property route. Gaurav Dalmia, the boss of First Capital India, a venture fund, notes that the very success of the big software companies prevents them from evolving in this direction: they are not under pressure because they can already count on comfortable returns, and the stockmarket might penalise them for taking the risk. Meanwhile, though, the R&D centres of western firms operating in India are being granted a bundle of patents.

However, even small and nimble firms will have to overcome a latent cultural resistance to mixing business and science that may have a religious base. The Hindu goddess of wealth is Lakshmi, the goddess of knowledge is Saraswati. The two never appear together.

Chinese puzzles

In Shenzen, the boss of Netac Technology, Frank Deng, personally holds around 20 patents. The company, which makes USB memory devices and MP3 music players, has filed for over 200 patents globally, some of which have been granted. Instead of plaques of patents on the wall, as at Qualcomm or Sasken, Mr Deng keeps five of them in two drawers beside his desk.

Netac is one of a growing number of companies that is investing in R&D and getting patents to protect its innovations. “We couldn't just follow the Chinese way, the old way, of doing manufacturing and competing on labour costs,” he says. “That is OK in the short term, but we didn't think it was the right way for the long term. We didn't want to be a follower but be a leader.” The company's enlightened attitude to intellectual property may reflect the fact that the founders were trained abroad and worked for big technology firms before starting their own business.

China is better known as a place of rampant intellectual-property infringement, not creation. When the Communists came to power, a rudimentary patent system then in existence was abolished and all inventions were deemed to belong to the state, so there was no incentive to invest in innovation. But now the country is on a long march towards respecting intellectual property, and some progress is being made, notably in IT and telecoms. The number of applications to China's patent office by Chinese inventors has doubled between 2000 and 2003, and that by foreign firms has quadrupled. The patent system is evolving fast, and enforcement, though lagging, is improving.

Take Huawei Technologies, a big vendor of communications equipment, with revenues of $5.6 billion in 2004. This year, revenue from abroad is expected to surpass that from domestic customers for the first time. Around half of its 34,000 employees do R&D work, claims the company. Its patent filings almost doubled each year during the 1990s, though they have recently started to slow somewhat: the number this year will be around 2,400, and from next year it is expected to settle at around 3,000 a year. In 1995 the company created a special department to work on patents, which currently has 100 people on the payroll but will expand to twice that number next year.

“If you didn't have patents, you would be in a very disadvantaged position relative to your competitors,” explains Liuping Song, the head of Huawei's intellectual-property department, at the firm's headquarters in Shenzen. “Other companies approach you and charge you for using their patents.” So is the firm chasing after patents simply because other companies are doing the same thing? Mr Song laughs and says, “That is a difficult question to answer.” Then he adds: “We have to play by the rules of the game.”

Finding out how to do that has been a long and difficult process. In 2003, Cisco Systems sued Huawei for copying its intellectual property, which eventually persuaded the Chinese firm to take the offending products off the market. Wiser after that and other experiences, Huawei now plans to use intellectual property to its advantage. It makes a point of taking part in standards groups and publishing research papers. “In many new technological fields, we will have our own contributions to the industry,” says Mr Song.

The same sort of thing is happening at other large private Chinese firms that are reaching out to global markets, such as Datang Mobile and ZTE, makers of telecoms equipment, and SMIC, a big semiconductor firm. Some Chinese firms have even turned the tables and begun asserting their own patents. Netac, for instance, sued Sony Electronics, claiming that Sony's factory in Wuxi infringes Netac's patents.

Yet, as in India, it will probably be smaller companies that take forward the development of

intellectual property, rather than the big firms or the state-owned enterprises that dominate the economy. “They are monopolies which have no need for IP,” explains Joseph Cho, the boss of Pacific Epoch, a Shanghai firm that analyses technology markets. “They have all the market share already.”

The number of patents applied for by Chinese inventors at America's patent office is small, but it increased sixfold in the 1990s. Taiwan, an island with 23m people, went from almost nothing in the 1980s to fourth in the number of patents granted, after America, Japan and Germany. “If their continental cousins have the same behaviour, I don't know how many millions of patents will fall on our heads in a couple of decades' time,” says Dominique Guellec, chief economist of the European Patent Office.

Much of the new interest in patents is driven by Chinese government policy. The country is hoping to become less dependent on foreign companies by developing home-grown standards in areas such as 3G, DVDs and encryption technology for Wi-Fi, which provides wireless internet access. If it succeeds, foreign companies will have to pay royalties to Chinese firms in order to sell products on the Chinese market, rather than the other way round. “China realises that if it wants to move up the ladder in technology, the first thing it needs to do is fix the IP problem,” says Qi Wang of UBS, an investment bank.

The start of something big

But is there sufficient incentive for India and China to innovate? Both countries will be able to exploit their labour-cost advantage for a long time to come yet. India will remain a centre of inexpensive software coding; China will remain a place for low-cost manufacturing. But both countries are so populous that they can do lots of things at once. They can keep doing the low-tech work and at the same time develop more high-tech activities, just as America watched its mid-western states become a rustbelt as Silicon Valley started to boom.

One important role for the big IT companies in India and China is to provide talented engineers with the opportunity to gain experience in management before they set up on their own. In America, Silicon Valley was built not so much by venture capitalists and inventors but by seasoned business executives who spent decades with leading IT companies before starting up on their own. This is just beginning to happen in India and China too.

This leads some critics to the conclusion that outsourcing IT work to China and India will prove to be unwise. In scrambling for short-term savings, American and European firms may be inviting long-term harm. Yossi Sheffi of MIT calls it “the outsourcing trap”: exporting low-end IT jobs will create new rivals that will eventually overtake their clients.

Whether or not that dire warning is justified, India and China are bound to emerge as hugely important centres of innovation, says Bruce Lehman, who served as commissioner of America's patent office during the 1990s. “My prediction would be that in 20 years' time India and China will both be responsible for more patents than the US.”

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The liquidity of innovation

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How the new market for intellectual property is changing the technology industry

THE term “patent” implies accessibility. It derives from the Latin *litterae patentes*, or “open letters”, which were public documents issued by a ruler that conferred certain rights, such as a rank, a title or an official appointment. In the past, there were patents of nobility, of land conveyance and of monopoly; now there are mainly patents of invention, and they are generally seen as a way of excluding others rather than opening up.

However, the etymology of the term throws light not only on the origins of intellectual property but also, perhaps, on its future. Just as in the beginning patents were as much about public disclosure as about private ownership, they are now starting to be used as a way of spreading technology more widely, albeit in the form of establishing property rights to it.

The intellectual-property system that developed in the West, and is now in use worldwide, has been widely criticised, and for good reason. But this survey has sought to show that the critics are missing the bigger picture. The role of intellectual property is changing from that of an asset used by businesses for their own purposes to that of an input for webs of innovation among clusters of firms. Intellectual property is moving from enabling a transfer of knowledge to creating a market for it. It is providing liquidity for innovation.

“Patents are more a form of currency than they are a brick wall,” explains David Kaefer of Microsoft. These days, companies are using intellectual property to provide legal certainty for their development community. Be it through licensing agreements, patent pools or a commons for open-source, innovations are increasingly being shared.

But there is a risk that the industry as a whole might suffer unless even more intellectual-property

exchanges can take place. “The question is, are we going to create a world where a few big people create peace for their fiefdoms, or a marketplace for ideas, recognising that the system is not a perfect market?” asks Mr Kaefer.

To some, the very idea of turning the patent system into a market is repellent. “It is like a market for forged banknotes...you can't argue for [such a] market simply because it trades,” says Rishab Aiyer Ghosh of the University of Maastricht and editor of a recent book, “CODE: Collaboration, Ownership and the Digital Economy”. Software should be protected by copyright, he believes, but patents discourage follow-on innovations.

Questioning the legitimacy of patents is nothing new. In the early days of electricity, for example, there were debates over whether such innovations should be awarded patents at all, because electricity appeared to be a natural phenomenon, and new ways of harnessing it seemed to be more of a discovery, not an invention. Similar debates are now in progress about software patents and gene sequences.

You gain, I don't lose

Some critics believe that the very concept of intellectual property is mistaken. Unlike physical property, ideas are non-rivalrous goods that can be used by many people at the same time without making them any less useful. The term “intellectual property” was widely adopted only in the 1960s, as a way to bundle trademarks, copyrights and patents. Those critics argue that today's rights are too strict and make the sharing of knowledge too expensive.

On an individual basis, this may be true. But something changes when these transactions increase in volume and value. Sharing, as this survey has tried to show, can add more value to an innovation than hoarding it might do. Yet effective sharing requires a property right that can be traded in a market.

“This is a big, big shift and it is continuing,” explains IBM's Mr Kelly. “And in any kind of shift, you see all sorts of gears not meshing and all kinds of misbehaviour.” Certainly the problems in today's system are real and growing. Reforms are needed. “What is often not recognised is...how the assertion of intellectual property can raise transaction costs and inhibit the development of organisational capital,” notes Philip Evans of the Boston Consulting Group. “One innovator's royalties are the next innovator's costs of doing business. There is nothing in economics to say that high rewards and high costs make for a more innovative regime than low rewards and low costs.”

What he is saying is that it may be better to limit rather than expand the scope, duration and protection provided by intellectual property. But there is no way of being sure without serious economic study. Inexcusably, that has been lacking. Intellectual-property policies are often made without a proper basis, and strongly influenced by private lobbying.

A first step towards a more coherent policy is the Adelphi Charter issued earlier this month by a prominent group of intellectual-property experts organised by the Royal Society of Arts in London. One of its merits is to lay down a public-interest test for governments to use before expanding intellectual-property rights. The default option, it says, should be to leave well alone, and the burden of proof should be on the advocates of change.

The current intellectual-property system was created by the rich world, which is presumed to hold all the property and license it to the rest of the world. But as emerging India and China, among other places, develop patents of their own, the rich countries will start to see the system from a different perspective.

They got a glimpse of this in the period after September 11th 2001, when anthrax germs were being sent to American recipients by post. Politicians immediately considered legislation to compel the German maker of an anti-anthrax drug to grant a licence for its production—only months after American trade officials had lambasted poor countries for considering something similar for AIDS drugs.

More such hypocrisy will be exposed as the rich world becomes a licensee as well as a licensor of technology. A report issued by America's National Intelligence Council earlier this year asked whether the global liberal trading order could survive the rise of China. Over the next half-century, America will be forced to re-examine its free-trade views, especially in the area of intellectual-property rights.

An open and shut case

The paradox about intellectual property in IT and telecommunications is that it eases the exchange of technology and acts as a bottleneck for innovation at the same time. The whole system is in a stage of transformation. “Markets require institutions, and institutions take a long time to develop. Today, the institutions for a ‘market for technology’ are not well developed, and it is costly to use this market,” says Alfonso Gambardella of Bocconi University in Milan. As patents become more valuable to those who hold them, they may also become socially more valuable by stimulating R&D or promoting the use of technology specialists, says Ashish Arora of Carnegie Mellon University.

Ideas are to the information age what the physical environment was to the industrial one: the raw material of economic progress. Just as pollution or an irresponsible use of property rights threatens land and climate, so an overly stringent system of intellectual-property rights risks holding back technological progress. Disruptive innovation that threatens the existing order must be encouraged, but the need to protect ideas must not be used as an excuse for greed. Finding the right balance will test the industry, policymakers and the public in the years ahead.

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The internet

The battle of the portals

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Why Microsoft, Google and Yahoo! are fighting over AOL

Get article background

AS MORE and more of the world's business is conducted online, a battle royal is taking shape. The struggle is to decide which company will become the primary gateway to the internet. Three firms, Google, Microsoft and Yahoo!, are aiming to establish the world's leading internet portal—the site that most internet users rely on for everything from searching the web to sending e-mail and catching up on the news. All three firms are hoping to strike some sort of deal with AOL—the fourth player in the battle of the portals.

It is highly convenient for Time Warner, the world's biggest media company, that its struggling web portal, AOL, is suddenly at the receiving end of competing bids from all three of the other internet giants. Microsoft, the world's biggest software company, was the first to start haggling, via its portal, MSN. Then Google, the world's most popular search engine and nowadays Microsoft's archest arch-enemy, came running, with Comcast, America's biggest cable company, as a prospective co-bidder. And now Yahoo!, the biggest web portal and determined runner-up to Google in internet search, has also entered the bidding.

Lest anybody pick the wrong metaphor, it is not the case that AOL is “the prettiest girl at the dance”, says Safa Rashtchy, an analyst at Piper Jaffray, a bank. Instead, he says, AOL “is big open real estate and you don't want your competitor to get it.” That is because the vaguely defined and fast-changing “web-portal” industry, though still young enough to be the fastest-growing

advertising medium, is also showing the early signs of maturity. That would suggest that this industry, like many others, will evolve towards three large generalist players and several small niche firms, a phenomenon that Jagdish Sheth and Rajendra Sisodia, two academics, call “the rule of three” in a book of the same title. The big question is which three emerge and in what combination.

Analysing how the four portals currently measure up is surprisingly hard. Conventional wisdom says that Google is the one to beat. That is because it is the clear leader in internet search—the most technologically exciting and profitable end of the business. Yahoo! is a strong second in search and MSN a poor third, whereas AOL does not compete in search at all. Instead, it uses Google's technology to generate search results and to make money out of them (by placing the hyperlinks of advertisers near related search results).

But when the criterion is not the number of searches but the number of site visitors in America, Yahoo! is the clear leader, with MSN in second place, AOL in third and Google last. Terry Semel, Yahoo!'s boss, used this fact to make a barbed joke when speaking at an internet conference in San Francisco last week: “Gosh, it's starting to look more and more like a portal,” he said of Google, whom he is suspected of envying, and “as a portal it would probably be rated number four.” Yahoo!'s web mail service, he added, has ten times as many users as Google's alternative.

If instant-messaging (IM) technology is the measure, AOL is the clear leader, with Yahoo! and MSN competing for second place (and, last week, linking their technologies in a partnership), while Google is again last. Instant messaging is currently hard to make money out of, but potentially crucial since it is one vehicle for free internet telephony and tends to make its users fiercely loyal.

By the more conventional measures of advertising revenues and operating profit, Google is still the clear leader and MSN the big loser, says Henry Blodget, the president of Cherry Hill Research (Mr Blodget became notorious as an equity analyst at Merrill Lynch for his role in inflating the dotcom bubble, which led to his being banned from the securities industry for life). After making losses for about a decade, MSN is now expected to make an operating profit of about $500m this year, a sharp contrast with an estimated $2.4 billion for Google. “The web war is over,” argues Mr Blodget, “and Microsoft lost.”

This might suggest that a combination of AOL with MSN makes the most sense. Both are unhappy step-children of parents that live in other industries (Microsoft in software, Time Warner in traditional—ie, offline—media), whereas Yahoo! and Google remain the pure internet businesses they have been since their inception. For MSN, switching AOL away from Google's search technology and towards MSN's might offer a last chance of staying in the search competition. And both MSN and AOL still have lucrative but fast-shrinking side businesses in dial-up internet access, which Google and Yahoo! scoff at as holdovers from the narrowband stone age.

By contrast, Google would at first glance seem to be the least likely partner. It is run by technology purists—proud geeks who preach that computer algorithms, not human editors, will change the world. On the other hand, as confident as Google currently is, AOL is its single largest customer, accounting for 11% of its revenues in the first half of this year. Google would prefer not to lose this to MSN, so its bid appears to be defensive. “Google would probably not have done this if MSN had not made this move,” says Hal Varian, an academic and adviser to Google. This would explain why its bid is intended as a joint-venture. The idea is that Comcast would bring the broadband internet access, AOL the media content and “eyeballs”, and Google would do the “monetisation” through its advertising technology. This would ensure that each partner concentrated on the bit of the business in which it really excels.

A Google-Comcast-AOL combination would also be the most effective counter to Yahoo!'s (so far) successful strategy of teaming up with broadband providers. Yahoo! has deals with SBC and

Verizon, America's two largest phone companies, to give their broadband customers free Yahoo! accounts, web mail and online storage; this week Yahoo! struck a similar deal with BellSouth, the country's third-largest telephone company. Google, the only portal that does not make content of its own, and Comcast, the biggest broadband provider in America, are feeling a bit left out.

But a deal between AOL and Yahoo! might be culturally the easiest. Both are at heart media companies—Yahoo!'s Mr Semel made his career in Hollywood before moving to Silicon Valley. Both see media content, whether generated by teenage bloggers or professional film studios, as their natural terrain.

Ultimately, it all comes down to the three suitors' estimates of what Mr Varian calls “the power of the default”. Default users are “the great unwashed”, says Mr Varian. They are the ones who, for instance, use MSN because it comes pre-installed in Internet Explorer, the web browser that itself comes pre-installed on new computers. By contrast, teenagers and geeks mix and match their web mail, IM, online maps, search, blogging and so on from whichever service on the internet they happen to like best. Default users are less demanding, older but nonetheless rich enough to target with small hyperlinked text advertisements. For the dealmakers, it all comes down to figuring out how much these naifs, collectively, are worth.

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The car industry

Death by red ink

Oct 20th 2005
From The Economist print edition

Rare good news from Detroit is unlikely to persist

AP

Buy now, while GM lasts

Get article background

GENERAL MOTORS still insists on referring to itself as “the world's largest automaker”. But some people—including some company insiders—are beginning to worry that it could also become the world's biggest bankruptcy. And America's second largest car manufacturer, Ford, could follow suit.

On October 17th, GM succeeded in putting a positive spin on its dismal third-quarter financial report. GM shares initially jumped by as much as 10%, in response to the company's claim that it is finally getting to grips with the soaring cost of health care for its employees and pensioners. Shaving $1 billion off its annual health-care bill of $6 billion, through a deal with the unions, is a real achievement. But the truth is that GM still lost $1.6 billion in the last quarter, taking annual losses to $3.8 billion so far this year. Despite strong numbers from its Chinese operations and a nascent turnaround in Europe, the core North American market in effect accounted for that entire flood of red ink. GM has been virtually giving away its cars and trucks this year, most recently with an incentive programme offering to ordinary customers discounts usually reserved for employees. Despite this, the carmaker's market share took a disastrous tumble during the July-September quarter, to 25.6% compared with 28.5% during the same period the year before.

There were a couple of small, bright spots. GMAC, the group's lending unit, netted $675m for the three-month period, much of that from writing loans for car and lorry sales. And Rick Wagoner, GM's chairman, was able to announce those health-care savings. But even these hard-won concessions from union retirees may quickly be overtaken by rapidly rising American medical costs. The United Autoworkers Union will probably not consider bigger concessions until 2007

when it is due to return to the bargaining table to renegotiate its four-year contract. In the meantime, GMAC may be sold off: Mr Wagoner announced he would be willing to sell a controlling stake in the finance unit, which has propped up its parent for the better part of two decades.

Even with GM promising to shave another $1 billion off its product development bill, there are plenty of reasons for scepticism about the company's future. The carmaker could be saddled with billions in additional pension and other costs as a result of the recently-announced bankruptcy of Delphi, its former parts-making arm. The increase in petrol prices may have made many buyers turn away from the sport-utility vehicles (SUVs) that long supported Detroit's balance sheet. The costly re-launch of full-size SUVs, such as the Chevrolet Tahoe in early 2006, may not counteract this trend.

Various ratings firms have signalled the possibility of further downgrades in GM debt. And more and more observers are wondering how long Mr Wagoner can hang onto his job, especially as Kirk Kerkorian, an octogenarian corporate raider based in Las Vegas, begins to flex his muscles. Mr Kerkorian failed in his bid to take over Chrysler a decade ago, but it is increasingly likely that his ally, Jerry York, will get a seat on the GM board. From there, Mr York, himself a former Chrysler executive, could become a convenient replacement for Mr Wagoner.

Ford, meanwhile, was expected to announce a loss of its own as *The Economist* went to press. Its headline numbers are likely to be less alarming than GM's. But the firm's fundamental situation may not be much better. Its market share is tumbling again, after a brief incentive-led surge earlier this year. And Ford has even fewer new products in the pipeline than does General Motors. In recent weeks, a number of top bosses have tendered their resignations, including Phil Martens, its North American product-development chief. A new boss, Mark Fields, assumed command of Ford's core Americas unit on October 1st. If that heralds a much-needed shake-up, there may someday be good news to come out of Detroit.

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Economist.com BUSINESS

Oil companies

Starting to splurge

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The big names in the oil industry are starting to loosen their purse strings

THE western world's biggest oil companies are “cash rich but opportunity poor.” That is how the old lags of the business saw things until recently. Now, a spike of activity and investment in India and China has observers wondering if the industry is poised for a spending spree.

The biggest private-sector firms have enjoyed massive profits in recent years, thanks to skyrocketing oil prices. Exxon Mobil earned $25 billion in profits last year, while Royal Dutch Shell made $18.2 billion, the highest corporate profits in British history. Surprisingly, though, they have not used their rapidly accumulating piles of cash to splurge on big acquisitions or greatly boost spending, as in previous booms. Instead oil bosses have been shovelling money back towards shareholders.

One technique has been to buy back (and retire) their own shares; this is popular with shareholders both for its tax advantages and because it raises the value of the remaining shares. Since 2000, the biggest private-sector oil firms have gobbled up $85 billion of their own shares. Another way firms have handed back cash to shareholders is through special dividends. BP has just announced that the net proceeds from the $9 billion sale of its petrochemical unit will go straight to shareholders.

And yet, belatedly, the mood seems to be changing. The big oil firms now seem keen to throw money at projects in Asia. BP has also just announced a $3 billion deal with Hindustan Petroleum, a partly state-owned Indian firm, to build oil refineries and petrol stations in India. Exxon Mobil, Chevron Texaco and BP are now thought to be wooing Reliance, an Indian energy firm, for a stake in a big new gas field in the Bay of Bengal. Chinese whispers suggest that BP may also soon announce a new joint venture with Sinopec, a partly government-owned Chinese firm, in refining and marketing fuels. Exxon is already pushing ahead with plans for a refining joint-venture there too.

Compared with the amounts of money being returned to shareholders, these are still relatively small investments. So why have big oil firms been so slow to take the plunge with large new investments? One reason is that oil executives—with Exxon bosses in the lead—mostly believe that today's oil prices will not last. They are haunted by the memory of $10 oil, and the fear of another price collapse has proved a powerful check on any desire to expand their empires. So too has the fact that the oil-price hike has greatly inflated the price of potential acquisitions. Shrewd oil investors reckon there are few bargains left, and oil bosses mostly agree.

The notable exception is Chevron's David O'Reilly. His controversial and pricey acquisition of Unocal, an American firm, earlier this year snatched the prize away from China's CNOOC. It is no surprise, then, that Mr O'Reilly has been noisily claiming that higher oil prices might be here to stay. “The time when we could count on cheap oil and even cheaper natural gas is clearly ending,” he warned a gathering of energy executives earlier this year. The recent upturn in spending, in Asia and elsewhere, by big oil firms suggests that others are now coming round to Mr O'Reilly's

way of thinking.

But even if the world's leading oil firms take a more aggressive attitude to new investment, they will struggle to find good ways to expand their business. The rise of resource nationalism among petroleum-exporting countries has made life much harder. That is because the cheapest, best and biggest oil reserves in the world are in the hands of governments, not Exxon or BP. And from Russia to Venezuela, those governments are increasingly removing the welcome mat for western firms. Given that government oil companies have stitched up the best fields, the big private-sector oil companies are being forced to explore increasingly marginal sites. As a result, the one area where the big oil firms have had to spend heavily is in exploration. But although investment went up by nearly a fifth to about $200 billion last year, net oil reserves held by the oil majors at the end of 2004 had hardly changed from the level of a year earlier.

Andrew Latham of Wood Mackenzie, a Scottish energy consultancy, argues that the big firms now need to spend even more on exploration. If not, he warns, they “face not replacing their production with new fields”. This would lead to an increasing dependence by the rich world on supplies from OPEC, and higher energy prices. The latest splurge of activity in India and China suggests that the biggest firms may be taking this message on board.

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Economist.com BUSINESS

African railways

All aboard the lunatic express

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Can privatisation save Africa's railways?

THE 2,350-kilometre (1,460-mile) railway linking Mombasa with Kampala, nicknamed the “lunatic express”, was meant to be the economic backbone of East Africa. Nairobi and many lesser towns were built to service it. Commodity crops, minerals and occasional giraffes trundled down it to Mombasa on the Indian Ocean; manufactured goods, hymnals and white hunters laboured up-country on it. Difficult operating conditions since independence (including several blood-soaked regimes in Uganda), inept management, pilfering and an unhelpfully narrow gauge have combined to ruin it. Freight traffic has halved since 1983. Kenyan state railways, which runs the longer bit of the line, has debts of $270m or so. To save the railway and to service their debts, Kenya and Uganda agreed last year to privatise it.

There were seven bidders and two finalists. The winner, announced on October 14th, was a consortium led by Sheltam Trade Close, a South African firm. It handily beat out a consortium backed by Rail India, the empire-building bit of India's state railways. The Indians offered the two governments 6% of annual gross revenues and insisted on subsidies for running passenger lines. This was perhaps a trifle ambitious given local bureaucrats' eye for an earner. Sheltam was extravagant by contrast, promising 11% of revenues and paying $1m for the privilege of running Nairobi's ramshackle commuter lines.

Sheltam reckons it will spend $322m overhauling the railway and its rolling stock over the next 25 years. A lunatic proposition, some say. Perfectly sane, says Sheltam. The company has ambitions to expand rail traffic across Africa. It argues that well-run railways will have a competitive advantage for heavy traffic, since they are often competing against choked and potholed roads. Sheltam has already renamed the line Rift Valley Railways. It says about half of the 7,200 railway workers in Kenya and Uganda will lose their jobs. That is hard, but might be a price worth paying if the railway can better integrate the economies of East Africa.

E-business in India

Made for each other

Oct 20th 2005 | DELHI
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Modern technology and Indian marriage: a match made in heaven

SOME 18 months ago in southern India, the parents of a software engineer working in Chennai began to despair of finding him a suitable bride. They were, truth to tell, rather picky: “Our requirement is a suitable Hindu Nadar girl of Sivakasi /Madurai side origin, preferably employed as a software engineer in Chennai, age between 21 to 24, height 5 feet 2 inches to 5 feet 6 inches (157cms to 167cms) and sufficiently good-looking.” She also had to speak Tamil.

There was, however, a happy ending. They ventured online, to a website called Bharatmatrimony.com, which now flaunts their story. They identified a girl, received a message from her father, matched horoscopes and, having introduced the happy couple to each other, will celebrate the wedding next month.

Online marriage-broking is one of the successes of Indian e-business, used by the single looking for “love matches” as well as by their parents and siblings. So complex are the requirements of Indians seeking a partner that the internet might have been designed to meet their needs. Bharatmatrimony's boss, Janakiram Murugavel, says that language is the biggest criterion. His site is divided into 15 linguistic sections. Then comes status and caste, which divides Indians at birth into thousands of groups. About 70% of his customers want to marry within their caste. Most still also use astrology. Bharatmatrimony offers an online horoscope service.

Sadly, Indian lonely hearts and their parents seem no more trustworthy than those anywhere else. Many may be lying, or not lonely at all. Bharatmatrimony has a patent pending for its third-party verification service. Shaadi.com, a rival, boasts that all photographs are processed to ensure they are “100% tamper-free”.

Bharatmatrimony claims 7.5m members and Shaadi.com says its site had 1m visitors in the past month. But there is still hope for the old-fashioned, off-line matchmaker. India has 1.1 billion people, but fewer than 40m of them are thought to have access to the internet. Mr Murugavel estimates that the annual matchmaking market in India is worth about $250m. His company captures just $10m in revenues, and is expanding its off-line activities.

The internet is spreading fast in India, however, taking the brokers with it. Bharatmatrimony's original market was among Indian information-technology workers in America. Now, online matchmaking is reaching beyond India's big cities. The forces of globalisation, which many Indians fear might be the ruin of tradition, can also bolster it.

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Economist.com BUSINESS

Alitalia

Flights of fantasy

Oct 20th 2005 | ROME
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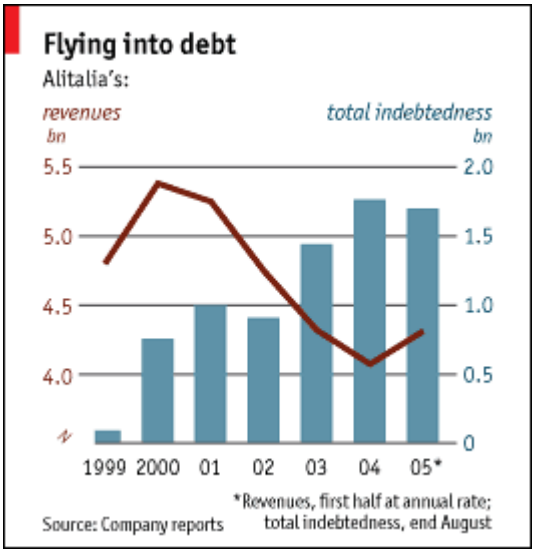
State-funded parachutes for Italy's national airline



IT IS laudable to have high ambitions. But when Alitalia, Italy's troubled national airline, says that it aims to be a "highly efficient network carrier", it risks being greeted with a hollow laugh. Yet, approving a revised corporate plan for 2005-08 on October 14th, Alitalia's board confirmed that this is just how it sees the airline.

The reality is that Alitalia has posted operating losses for every year between 1999 and 2004, and has accumulated net losses of about €2.4 billion ($2.4 billion) in those six years. It lost a further €122m during the first half of this year. The airline had debts of €1.7 billion at the end of August and now probably has only enough cash to carry on flying until the end of the year. Alitalia has kept airborne over the last year, largely thanks to a state-guaranteed bridging loan of €400m provided by Dresdner Kleinwort Wasserstein (DKW), a German bank. But that loan must be repaid by March next year. The financial position at the end of August showed a further €168m of debt falling due over the next year.

Like its competitors, Alitalia is feeling the effects of high fuel prices which, it expects, will add €320m to its costs next year. And low-cost carriers are carving out large slices of the Italian market; Ryanair operates 20 routes from Rome and 18 from Milan while Easyjet announced on October 12th that it will soon open a hub in Milan. So Alitalia's bankers have little to smile about, and they may wonder if the board's assurance that the airline will reach economic equilibrium next year is worth much.

Even so, Alitalia may pull through. If it does it will owe its survival, as it has in the past, to the helping hand of the Italian government, which owns 62.3% of the airline, and the tolerance of the European Commission, which is meant to crack down on state aid to loss-making businesses. Alitalia's trick this time seems to turn partly on spinning off non-flight operations, such as ground handling and maintenance, into a separate company called Alitalia Servizi. At the end of May, Alitalia's board approved an arrangement under which Fintecna, a company wholly-owned by the state, will become a shareholder in Alitalia Servizi. Fintecna will acquire all Alitalia Servizi's preference stock and 49% of its ordinary shares.

The European Commission's attitude to all this will be vital. Last month it ordered Olympic Airlines of Greece to repay millions in illegal state aid. But Alitalia says that the commission accepts that Fintecna's stake makes genuine commercial sense and is, therefore, not illegal state aid. All the same, some industry experts are sceptical that genuine private investors would be willing to put money into Alitalia and, unsurprisingly, leading European airlines have expressed their concerns to

the authorities in Brussels.

In November 2004 Alitalia said that it would launch a rights issue of €1.2 billion by the first months of 2005, but cash is running out while talk on this continues. Twisting and turning to get off the hook on which years of over-manning, weak management, poor service and political interference have impaled it, Alitalia now plans to raise up to $485m of new debt, pledging part of its elderly fleet in guarantee. Financial pyrotechnics may keep Italy's national airline flying for a while longer. But a sustainable long-term strategy still seems a long way off.

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Economist.com BUSINESS

Retailing

Carrefour at the crossroads

Oct 20th 2005 | PARIS
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Can Carrefour's new boss make the French supermarket giant shine again?

FOR a country in which “globalisation” is a swear word and big business is treated with deep suspicion, France boasts an awful lot of big, globally successful companies. One such is Carrefour, which is the world's second-largest retailer after Wal-Mart, an American firm. Carrefour brought hypermarkets, huge stores that sell a wide variety of goods in addition to food, to France in the 1960s. It was the first to sell own-brand products in the 1970s in France. For two decades it has forged ahead with international expansion, with particularly big investments in Latin America and China. It is now the world's most international retail chain with hypermarkets, supermarkets and deep-discount shops in 28 countries. Last year its annual post-tax sales hit €73 billion ($90 billion).

However, despite its huge size and rapid expansion, Carrefour is also a troubled company. Rivals have been stealing market-share in France, where the group generates roughly half its sales and profits. Last October Carrefour issued a profit warning. A few months later the five founding families that control the group lost patience with Daniel Bernard, who had been boss of Carrefour for more than 12 years. When José Luis Duran, the company's chief financial officer, replaced him in February, Mr Bernard did not go quietly: his €38.5m golden handshake shocked French public opinion and created more unwanted publicity for a firm under siege. Speculation was rife about a possible takeover of Carrefour by Wal-Mart or Tesco, a British supermarket chain.

That speculation has died down for now, but Mr Duran is under no illusions about the size of his task. The 40-year-old new boss says he is determined to repair the company's image and recapture its clout. His priority is to fix what he sees as Carrefour's two biggest strategic blunders in recent years: an over-aggressive expansion abroad and an incoherent pricing strategy at home.

Mr Duran says that, until he took over as boss, Carrefour had never withdrawn from a country where it was faring badly—with the single exception of Chile in 2003. This year Carrefour has pulled out of Japan and sold 29 hypermarkets in Mexico, where it could not compete with Walmex, the local version of Wal-Mart. It has also recently traded its hypermarkets in the Czech Republic and Slovakia to Tesco, in return for Tesco's stores in Taiwan. But Carrefour is simultaneously expanding its successful operations abroad. Since February it has bought 12 new supermarkets in Poland, ten in Brazil and 160 convenience stores in Italy. It took over the third-biggest supermarket chain in Turkey and opened new outlets in China, Indonesia, South Korea and Colombia. The company's capital expenditure this year will increase to €3.3 billion from €2.5 billion in 2004, allocated to fewer countries. “We want to be among the top three in a foreign market or not be present at all,” says Mr Duran.

Even more important for Carrefour's future is fixing the home market. The origins of its domestic problems may stem from a merger in 1999 with Promodès, another French supermarket chain. It was this deal that made Carrefour the world's second-biggest retailer. But the integration of the other retail giant went badly.

Dangerously, Carrefour has lost its reputation for low prices—something that remains fundamental to Wal-Mart's success. During the last years of his reign Mr Bernard focused on margins rather than sales volume while Leclerc and Auchan, its main domestic rivals, and deep-discounters such as Germany's Aldi and Lidl, cut prices to increase sales. Moreover, Carrefour's stop-and-go policy of cutting prices in the first half of the year and raising them in the run-up to the Christmas season irritated customers, who voted with their feet. Leclerc is today the leading operator of hypermarkets in France. Auchan is catching up.

In recent months, however, Carrefour has started to claw back market share. The group invested €300m in price cuts in 2004 and will spend another €300m or so this year. It also stopped its habit of putting up prices towards the end of the year. Mr Duran admits, however, that it will take time to restore customers' trust.

Carrefour's new price strategy alone is unlikely to do the trick. Mr Duran also intends to increase the range of products on offer by as much as 15% in hypermarkets and by one-tenth in supermarkets. He wants to employ more staff and lengthen the operating hours in the group's 100 biggest hypermarkets. Internet sales, however, are a tiny part of their business and likely to remain so. Despite France's large population of working mothers and fathers, Mr Duran, who is of Spanish-German origin, thinks that people in Latin cultures like to go to shops, to see and, if possible, to touch what is on offer.

Rumours about a possible takeover of Carrefour have not gone away. Mr Duran concedes that a bid for his group cannot be excluded. A real recovery would make Carrefour very expensive for potential buyers. Yet it will probably take time—and a pick-up of France's sluggish economic growth—before Carrefour can truly be confident that it is too big to swallow.

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Face value

Consulting in the right direction

Oct 20th 2005
From The Economist print edition

Orit Gadiesh has led Bain & Company from near-bankruptcy to surprising success

ANYONE who thinks that management consulting is an all-American affair run by men wielding Powerpoint presentations and sharp elbows should meet Orit Gadiesh. The soft-spoken executive chairman of Bain & Company, a consulting firm with its headquarters in Boston, Massachusetts, was born in Israel and served in the army there. Her father was an immigrant from Germany; her mother came from Russia.

Today Ms Gadiesh lives mostly in Paris with her British husband and a sheepdog called Guzel (Turkish for “beautiful”). She radiates continental European chic, clinking with bold silver jewellery that offers a sort of travelogue of her peripatetic working life. The advice she gives to clients—and she has retained a portfolio of them throughout her time as the firm's boss—is never parochial. She is as likely to tell a CEO to read “The Man Without Qualities”, one of her favourite novels, set in Vienna in 1913 and written originally in German by Robert Musil, as she is to promote Jim Collins's “Good to Great”, or some similarly popular American business book. She reads widely—fiction, history and biography in particular—“to stay connected and see the dots out there,” she says. “When I want a break I pick up a good book; I don't have to spend two hours getting to a golf course.”

Along the way Ms Gadiesh acquired an MBA from Harvard Business School. Although she spoke hardly a word of English when she first arrived on campus, she ended up among the top 5% of her year. Then she joined Bain, a firm founded in 1973 by a bunch of defectors from the Boston Consulting Group. Led by Bill Bain, the group wanted to set up a strategy-consulting firm that would not just give its clients a thick report on what they needed to do and then depart. They wanted to be involved in implementing their own recommendations, and to be judged by the results. This idea was revolutionary at the time, and it remains a core principle of the business

today. “Bainies”, as the firm's employees are known, are rewarded partly in line with the performance of the firms that they work for, and they have done well out of it. In Bain's corporate brochure is an audited chart showing the striking extent to which its clients' shares have outperformed the S&P 500 index in the past few years.

This has been reflected in the firm's own results. Although it is a private company and does not publish figures, the industry acknowledges that it is currently one of the most successful firms in the business, with consistent double-digit growth in both profits and revenue. It has established itself as the leading adviser to the private-equity industry, and has ridden on the back of that booming business. Its traditional way of working is well suited to private-equity firms. They tend to be manned by dealmakers, not managers—and so turn to Bain for a strategy to turn around the businesses that they buy. They then look to the firm to implement the strategy and produce a swift improvement in performance that will enable them to sell on the business at a handsome profit. It is the epitome of results-driven consulting.

Yet it was not so long ago that, as Ms Gadiesh acknowledges, Bain was close to bankruptcy. In the mid-1980s, the founders sold out in a deal that left the firm with a huge debt to service. Within a few years it had brought Bain to its knees. Ms Gadiesh, a psychologist by training, was given the job of mediating between the company and its founders, to persuade the latter to make concessions that would enable their creation to continue. She succeeded, but the morale of the firm was badly damaged. Some consultants were laid off; others were lured elsewhere.

Out of this crisis Ms Gadiesh emerged as a leader. At one crucial stage she gave a carefully considered speech with “no numbers” to the hard-nosed employees of a firm which stresses continually that it is “data-driven”. She talked about turning round the firm's “collective pride” and, using the metaphor of magnetic north (which shifts around every year) and true north (which is fixed), argued that it should not be swayed from its founding principles. She received a thunderous ovation. “Everybody walked away completely in awe,” said one witness. Soon after (in July 1993), Ms Gadiesh was appointed chairman of Bain, the only woman ever to have led a big consulting firm. “Gender has never been an issue for me,” she says, though “it has been an issue for other people.”

Aiming straight

The true-north idea was inspired partly by Ms Gadiesh's husband—a keen sailor who has rounded Cape Horn single-handed—and it has since become embedded in the firm's culture. Bain's logo is a compass pointing a few degrees to the right of vertical, and Bainies use the phrase all the time. In the firm's Paris office there is a printed notice above the men's loo: “*Veuillez viser juste, s'il vous plait. Le 'True North' c'est droit devant*.” (“Please aim straight. 'True North' is directly in front of you.”)

David Maister, an adviser to professional service firms and once a Harvard Business School academic, wrote recently that “the most successful organisations have an ideology. There is a McKinsey way, a Goldman Sachs approach and a Bain philosophy, to take only three examples of firms with strong ideologies and the financial success to match.” That is exalted company for a down-to-earth philosophy that has as one of its principles what Ms Gadiesh calls the “80/100 rule”: the most brilliant solution to a business problem is useless if it cannot be implemented, so look for the 80% perfect answer that can actually make a difference to a client's results.

Sticking to its principles has served Bain well. But it is not a risk-free strategy. The firm was late to set up a specialist IT unit because (in principle) Bainies are generalists. And it has a low profile in the fast-growing public-sector consulting business, partly because its fee structure is inflexible. Head true north too blindly and you might eventually hit an iceberg.

Economist.com FINANCE & ECONOMICS

Financing terrorism

Looking in the wrong places

Oct 20th 2005 | DUBAI, LONDON AND SHARM EL-SHEIKH
From The Economist print edition

Hindering flows across international financial networks is costly and does not stop terrorists' primary activity

Get article background

UNDER the scorching sun in Egypt's inhospitable Sinai peninsula, security forces last month drew a tight cordon around terrorist suspects holed up in caves on Halal Mountain, hoping to starve them out. The authorities have been on high alert after several terror attacks, most recently in the Red Sea holiday town of Sharm el-Sheikh, where scores of tourists and locals were killed in July.

As the security forces waited, a more staid faction in the global fight against terror gathered in one of the resort's luxury hotels. Under the watchful eyes of officials from America's Treasury, nearly 200 grey-suited bankers from the Middle East and Africa spent two days discussing recommended financial safeguards to choke terrorist funding and money laundering, another crime that abuses the financial system. “This is about creating hostile environments,” said Neil Bennett of Britain's National Terrorist Financial Investigation Unit. Last week an even bigger gathering took place in Paris, as officials from 32 jurisdictions and 16 international organisations debated the uneven pace of progress in reducing financial crime, including that linked to terrorism.

Four years after the attacks of September 11th 2001 put the “war on terror” at the top of George Bush's agenda, political pressure from America, Britain and, more recently, the United Nations, has resulted in this: scores of bankers, fund managers, accountants and solicitors on the lookout for terrorists around the world. “Money is the lifeblood of terrorist operations,” declared Mr Bush: “We're asking the world to stop payment.” Tony Blair has beaten the same drum more loudly since the attacks in London on July 7th. Governments from Australia to Bangladesh and Paraguay have ratcheted up their political rhetoric too. Yet deadly attacks keep coming—most recently in Bali, Indonesia on October 1st.

The private sector bears the major burden of the effort to choke off funding for terrorists. Banks and other financial institutions are scanning their customer accounts more carefully for signs of

suspicious people and transactions. Accounts have been frozen and foreign banks have been cut off from doing business in dollars if America is not satisfied that they are properly sharing information.

Millions of prospective and current customers are hampered by tougher compliance standards. To open an account or transfer money these days means numerous demands for identification—a passport or driver's licence with a photograph. Customers have grown used to delays in gaining access to their own money. There are growing requirements for disclosure of detailed information on business directors and funding sources. All this means additional fees. Expatriate executives, international-exchange students and low-wage workers wiring money to their families abroad have been most affected.

The compliance costs for financial institutions are substantial. Graham Dillon of KPMG, a consultancy, reckons it costs each mid-tier bank in Britain £3m-4m ($5m-6m) to implement a global screening programme that involves regularly checking customer names—and those of third parties involved in their transactions—against United Nations embargo and American sanctions lists for possible terrorist matches. He reckons multinational banks each spend another £2m-3m per year to oversee implementation in their far-flung operations (such institutions commonly have 70 to 100 different transaction systems). In addition, “tens of millions of pounds” are spent each year in London alone on data storage and retrieval to satisfy a requirement that banks' client and transaction data be kept for five to seven years. Similar rules exist in America, Singapore and other European countries.

An exhaustive, one-time process known as “remediation”, in which institutions painstakingly go through their databases of existing customers to verify personal information and check names against sanctions lists, can cost a large multinational bank between £20m and £30m, KPMG estimates. There is increasing emphasis on this process in America. In Britain, though, regulators scrapped the requirement as too costly after several retail banks had undergone the process; it has been downgraded to a recommendation.

A costly pursuit

The total cost of complying with anti-terror financing regulations is difficult to determine partly because many institutions (private and governmental) tackle the issue in tandem with money laundering, a separate financial crime. The British Bankers' Association (BBA) estimates that banks in Britain spend about £250m each year to comply with regulations on the two sorts of crime. According to a global study of about 200 banks last year by KPMG, those interviewed increased investments on anti-money-laundering activities by an average of 61% in the prior three years.

But Mr Dillon says anti-money-laundering technology is focused on identifying suspicious transactions that bear little resemblance to those typically used by terrorists. He contends that current technology could be reconfigured to check for things that better fit the profile of terrorist financing—liquidating accounts, for instance (what one might expect of a suicide-bomber) or purchasing high-risk materials. But he is not aware of institutions doing this now. “There's a high probability that institutions have not learned from Madrid, 9/11 or the London bombings in relation to re-enhancing their systems against terrorist attacks,” he says.

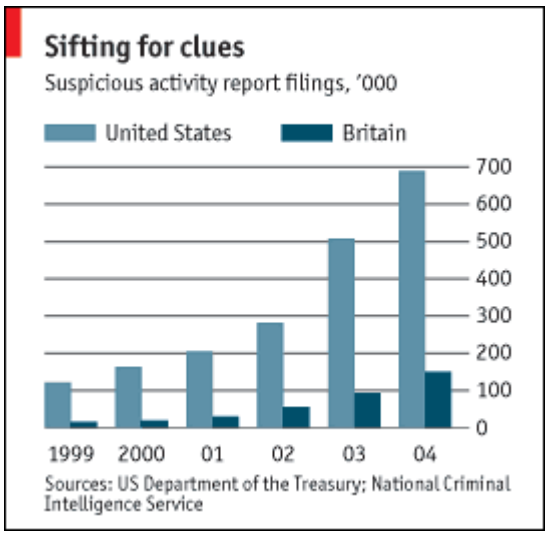
Meanwhile, the compliance staffing and services industries are booming. Compliance officers' salaries have climbed. Software vendors tout programs that can quickly scan millions of transaction records (big banks typically have more than 150m customer accounts and might have upwards of 20,000 staff). Specialist training programmes are designed to teach bank staff the latest in behavioural analysis. Private firms offer vast databases that allow banks to do background checks on new and existing clients. One such firm, World-Check, offers banks and

governments profiles of more than 300,000 people who may present a “heightened risk” to financial institutions.

The result has been a veritable flood of data on customer transactions deemed suspicious. In America, institutions file reports on about 13m cash transactions over $10,000 every day. The total number of “suspicious activity reports” filed nationwide more than tripled between 2001 and 2004, surpassing 685,000 that year. In Britain, about 250,000 such reports will be filed this year, about three-fifths of them from banks. The BBA estimates only 3-4% of the suspicious activity reports filed in Britain involve terror financing.

Ironically, the welter of paper has prompted some authorities to ask financial institutions to file fewer, better quality reports. Without sufficient resources to process the reports, backlogs mount and many cases are never carefully reviewed. In developing countries, law enforcement is too corrupt or inefficient to process them all. Banks also gripe about poor feedback from the authorities. A report commissioned by Britain's government and police chiefs and released on September 29th finds many flaws in the system of handling suspicious activity reports in money-laundering cases. It contends that the reports are under-utilised by most law-enforcement agencies, which simply lack the resources to analyse and act on the information in them.

Banks comply with the rules for two primary reasons: fear of sanctions, and worry about their reputations. Should they fail to toe the line, the Patriot Act essentially cuts off foreign institutions from business relations with America. That provision “scared the living daylights out of the rest of the world”, says a security consultant. “They realised that without dollar accounts they were sitting ducks.” For those institutions that fail to comply with the regulations, there is a price to pay: the American unit of Arab Bank, for example, was recently slapped with a $24m civil fine for having inadequate financial controls in place. It faces other suits for allegedly funnelling money to Palestinian extremists.



In more zealous places like America and Britain, the dragnet requires the filing of suspicious activity reports by lawyers, accountants and insurance companies as well. Las Vegas casinos are screening high rollers. Even yacht brokers and jewellers have been told to report buyers who try to pay with big rolls of cash.

Yet all this effort has yielded depressingly few tangible results. America's Treasury says more than 1,000 grand-jury subpoenas and more than 150 indictments have been handed down, although there has been nothing like that many convictions. In July, an American court sentenced a Yemeni cleric to 75 years in prison for conspiracy to support al-Qaeda and Hamas. In Yemen, “they call me the father of needy people,” he told the court, proclaiming his innocence.

Such cases are rare, though. Many experts, both in government and the private sector, admit that the chances of detecting terrorists' funds in a bank sufficiently far in advance of a planned attack that it can be prevented are incredibly small. “In my view, it's hardly worth the effort,” says one banking industry official in Europe.

Critics note that a number of terror attacks have occurred this year—in Saudi Arabia, Jordan, Russia, Egypt, Britain, Bali (again), not to mention Iraq—and they often seem to involve very little money. The young men who tried but failed to detonate home-made bombs on London's transport system on July 21st packed explosives into cheap plastic containers of the kind that are sold in

Indian shops, the sort of things that housewives use to store left-over curry. Even the most devastating terror attacks cost relatively little to pull off. Estimates vary, but western officials say al-Qaeda operatives spent $350,000 to $500,000 to plan and carry out the September 11th attacks. The Madrid bombings cost about $15,000, the earlier Bali bombings $15,000 to $35,000.

Identification of terrorist funds is complicated by the increasingly fragmented nature of terror groups, says Rohan Gunaratna, a Singapore-based expert on al-Qaeda. “Targeting the known financial infrastructure will give you no guarantee that the threat has been diminished because some cells won't ever come on your radar screen.”

Keeping bad company

The effort to choke off terrorists' financing has been slow to adapt. Initially, programmes were designed as if al-Qaeda was a big multinational corporation with Osama bin Laden at the helm. “The crackdown on terrorist financing didn't amount to much, for it soon became clear that al-Qaeda was not some accounting trick that could be uncovered and righted by regulators willing to spend a few weeks in Grand Cayman,” writes William Brittain-Catlin, a journalist and security consultant, in a new book on financial crime*. Rather, he argues, al-Qaeda was a disjointed, fragmentary organism operating at street level in western cities, where disillusioned young men formed small groups and engaged in small-scale financial fraud, stole identities and credit-card data, communicated through the internet and cell phones, typically using multiple identities to escape capture and detection.

Indeed, the terrorists have shown an ability to keep changing their money flows. “The bad guys are definitely getting smarter,” says a European expert on financial crime. “The banking system is so well patrolled they're resorting to more primitive means.” Counter-terror experts say some groups have simply switched to using more cash, slipping across borders undetected. Authorities say they recognise the changing money flows, but cutting them off is no simple matter, particularly in cash-based economies with loose border controls.

The cash nexus

A controversial area of focus for counter-terror experts is the global network of informal money-transfer systems (known in some countries as *hawalas*), which have long been popular with overseas workers sending home remittances. They have come under particular scrutiny since September 11th, but have not been banned in most countries. Experts say *hawalas* are extremely hard to regulate and still offer one of the cheapest ways for poor people to send money abroad. Nikos Passas, an expert on financial crime at Northeastern University in Boston, says *hawalas* have had too much attention, given the wide range of fund-raising and transfer methods used by terrorists.

He and other experts contend that terrorist networks today are more likely to use money-laundering methods (such as falsified trade documents) for funds transfers. “Trade is not transparent,” according to Mr Passas, making it an attractive outlet for terrorist groups. Other experts agree, pointing, for example, to the falsification of documents by terrorist groups to launder money in Africa.

Nonetheless, one of the things that distinguishes Islamic terrorists from earlier groups—including the Irish Republican Army and Basque separatists—is their use of significant funds from legitimate (as opposed to criminal) sources. Much of the money for the September 11th attacks came from charities and wealthy individuals in the Persian Gulf region, especially Saudi Arabia. While the

Saudis have passed a number of laws to crack down on regulation of charities since then, enforcement is uneven. America's Treasury has frozen the assets of 41 aid organisations globally for alleged links to terror groups. But Islam's obligation of *zakat*, or giving a portion of one's income to the poor, means that law enforcement's efforts have ruffled feathers among governments in Muslim-dominated countries.

Credit-card fraud, welfare fraud and smuggling are some of the other known sources of funds for terrorist activities in the West. Mr Gunaratna has pointed to Spain and Belgium as two centres for such activities. Funds from cigarette smuggling in America (packs are shipped from one state and resold at higher prices in another) have supported Hizbollah's operations in the past.

Given the mutating nature of terrorist financing, international regulators keep layering on new laws and recommendations in an effort to keep pace. The result is what Mr Passas calls a "regulatory tsunami". The multilateral effort is based on the notion that terrorists will exploit the weakest links in the global financial system. It got a boost in July when the United Nations passed Resolution 1617, which clears the way for governments to cut off support networks of al-Qaeda and the Taliban around the world. The resolution calls on states to freeze the assets, cut off financial access and block foreign travel of anyone supporting these groups.

Specific recommendations for governments (which have the final say in enacting national laws regulating financial services) come from the unimaginatively named Financial Action Task Force (FATF), an international body based in Paris. It has developed nine recommendations, including the regulation of wire transfers, remittance systems (*hawalas*) and non-profit organisations, to complement 40 already in place to fight money laundering. So far 151 countries have committed to implementing the recommendations, but a recent report from the IMF and World Bank says countries' action on the anti-terror recommendations lags efforts to fight money laundering.

Part of the challenge is a lack of teeth. The FATF contends its main source of leverage is a blacklist of countries that have failed to adopt or implement adequate laws. The list contained 15 countries in 2000, including places like the Cayman Islands and Lebanon. Today only Nigeria and Myanmar remain on the blacklist (the Pacific island nation of Nauru was removed last week), but no one believes they are the only trouble spots. Indeed, sceptics question how some countries—Russia, Indonesia and Israel among them—have managed to avoid the list of shame. Passing laws, of course, is no guarantee of vigorous enforcement. "The gap between rhetoric and reality is not only in the developing world," says a World Bank official. "It exists in the West too."

Networks apart

Most problematic of all may be the 41 countries that do not even pretend to follow the FATF process. China is in the process of joining, and India has started discussions with the group. But Libya, Sudan, Vietnam and Venezuela remain outside the organisation. Africa is a particular concern. "Many countries in north and west Africa have not even reached step one—political commitment," says Alain Damais, head of the FATF.

For all the finger-pointing, though, experts admit that big financial centres such as London and New York—by virtue of the huge money flows going through them—are probably still major hubs for laundered funds and terror financing. Nick Kochan, author of another recent book on financial crime**, says Britain's government has failed to invest in sufficiently skilled law enforcement personnel or regulators to police its large financial sector.

For now the burden of implementation appears likely to rest with the private sector. "Banks are going to have to start behaving like the FBI and CIA," contends David Porter of Detica, a Britain-based consultancy with expertise in financial crime. "They need to start connecting the dots." This

“risk-based” approach—concentrating time and energy on checking a smaller number of individuals or businesses based upon their transaction histories, sources of funding and other factors—is gaining wider acceptance.

For KPMG's Mr Dillon, the resources already spent on the effort have handed a victory to the terrorists. “The cost to our global economy is so large, they've already had the effect they wanted,” he says. “The increasing costs of compliance and technology are a form of terrorism. We're damaging ourselves.”

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* “Offshore: The Dark Side of the Global Economy”

** “The Washing Machine: How Money Laundering and Terrorist Financing Soils Us”

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Economist.com FINANCE & ECONOMICS

Refco

Rotten yet robust

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From The Economist print edition

The demise of one of the world's top futures and commodities brokers shows both the resilience and the vulnerability of the financial system

EVEN in an industry known for breathtaking highs and gut-wrenching lows, the sudden collapse of Refco has been remarkable. A leading broker in futures and commodities, the American firm filed for bankruptcy on October 17th, a few days after allegations of fraud were levelled at its (now former) chief executive and only two months after its shares were floated on the stockmarket. Its demise has sent ripples through the world's financial centres: among the holders of its 200,000 client accounts in 14 countries were leading financial firms, hedge funds and other investors.

Also on October 17th, a consortium led by J.C. Flowers & Co, a private-equity firm, reached a preliminary deal to buy Refco's core futures-brokerage business for $768m, with an option on the rest of the company. To the fore is Christopher Flowers, a former Goldman Sachs banker known for diving into troubled waters and emerging with treasure: he made $1 billion resurrecting Japan's Long Term Credit Bank (now called Shinsei). His grip on Refco's futures business is not yet final, but Mr Flowers believes that he can revive it, because he thinks it is basically sound: what it most needs is the restoration of investors' confidence. Man Group, a futures giant, has backed off earlier expressions of interest in buying parts of Refco.

Refco's sheer size—it processed 654m derivatives contracts in the year to February 2005, more than the Chicago Board of Trade (CBOT) or the New York Mercantile Exchange—makes its collapse an important test of the resilience of several bits of the financial world. As the company's woes mounted last week, its share price plummeted by nearly three-quarters before trading was suspended on October 13th. Clients, and some employees, fled. But the regulated futures side of

the business, the part that most interests Mr Flowers and his partners, is still operational. This is important, given its presence on big futures exchanges from Chicago to London. Industry officials point to the CBOT's successful initial public offering on October 19th, when shares closed at $80.30, $26.30 above the launch price, as evidence that this side of the industry is sound.

None of this is much consolation to creditors nursing losses after Refco's fall. Trouble began on October 11th, when Refco revealed the findings of an internal audit. Phillip Bennett, its British-born chief executive, was said to have taken at least $430m in unauthorised loans. The money has since been returned; Mr Bennett has been charged with fraud, which he denies. Top of the creditors' list is BAWAG, an Austrian bank that lent €350m ($418m) to Mr Bennett to repay money he owed Refco. Other leading creditors include an arm of Wells Fargo, a big American bank; a fund managed by Jim Rogers, a well-known American investment adviser; a Moscow hedge fund; and firms in Italy, Venezuela and the Bahamas.

More broadly, questions remain about the fate of customers, many of them hedge funds, whose accounts were frozen when Refco Capital Markets, a now defunct (and unregulated) unit that specialised in off-exchange trading, primarily in foreign exchange, suspended operations on October 13th. Jean-René Giraud, an expert on hedge funds at Edhec-Risk, a consulting firm, says that such funds now face two potential problems: the inability to manage their strategies and get investors' money out; and, in a few weeks, a fall-off in the liquidity that Refco provided to the market, which may force funds to liquidate assets.

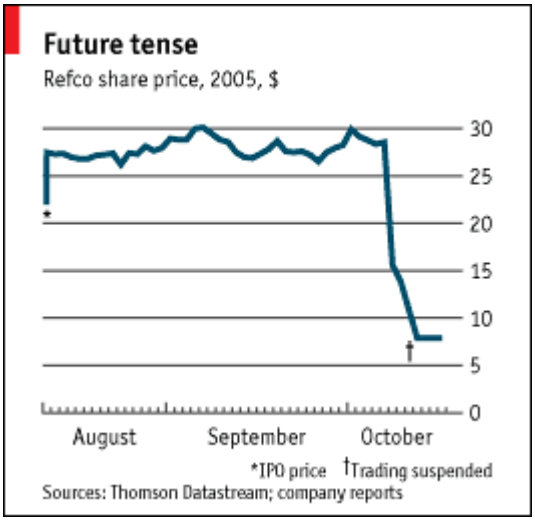
“If you're a client that holds any hedge-fund positions, you've got problems,” says a former Refco employee. Positions will be unwound, he adds, and this will mean losses for some. The effects will be delayed because hedge funds only need to report their positions monthly or quarterly. Those most likely to be affected, he says, are small hedge funds that did not have more than one clearing firm for their trades. One indication of the potential scope of problems facing firms that did business with Refco came from Moody's, a rating agency, which said on October 19th that at least 87 transactions in collateralised debt obligations that it had rated had been affected by Refco's bankruptcy. All are cash transactions, Moody's said; in other words, most are likely to be tied to Refco Capital Markets.

By coincidence, the Refco scandal has occurred as American lawmakers are conducting a regular review of the regulation of the commodities and futures industries. At the same time, the White House has put together a working group of interested agencies to consider possible changes. Big exchanges, notably the Chicago Mercantile Exchange, have urged Congress to bring off-exchange trading in currency derivatives, in which Refco Capital Markets was engaged, under the purview of the Commodity Futures Trading Commission. Other groups, including the International Swaps and Derivatives Association, which represents firms in the derivatives industry, claim that such rules would dampen volume. The Securities and Exchange Commission and big banks are also thought to be against extending the regulator's remit.

Meanwhile, another lively corner of the financial world feeling the effects of the Refco affair is private equity—chiefly because the stricken broker's largest shareholder is Thomas H. Lee Partners, one of the biggest names in the private-equity business. “How can a firm of Lee's reputation allow this to happen?” asks James Bianco, of Bianco Research in Chicago. “The best of the best stubbed his toe real bad on this deal.”

Several lawsuits have already been filed. Some accounting experts say it is almost inconceivable that a debt of $430m could remain hidden for an extended

period, suggesting it would take sophisticated means to conceal the receivables Mr Bennett allegedly shifted between firms. Could anyone else have known about the alleged fraud? Two class actions against Refco also name Grant Thornton, the firm's principal auditor, as a defendant, for not spotting the hole. Grant Thornton maintains that it was the victim of “purposeful deception”, adding that discrepancies in Refco's statements were “hidden well enough to also evade numerous other detailed financial inspections''.



Can parts of Refco's business be revived, as Mr Flowers thinks? Some in the industry predict an uphill climb. The futures clients that Refco may be able to retain, they believe, will be low-quality business that the firm picked up through its acquisition spree in recent years. As one long-time market-watcher puts it: “You don't get $430m in bad accounts with all stellar clients.”

Mr Flowers, however, expresses confidence that his consortium, which includes several other buy-out firms, such as Texas Pacific Group, can turn Refco's operating businesses around. He has brought in two other former Goldman Sachs partners, Mark Winkelman, who previously ran the investment bank's commodities group, and Jacob Goldfield, who recently spent a year as George Soros's chief investment officer. Their immediate aim is modest: to halt the departure of employees and to encourage customers to return. The next step will be to regain the now-bankrupt divisions covering unregulated trading in securities and commodities. “If we could restore it to what it was,” says Mr Flowers, “we would be delighted.”

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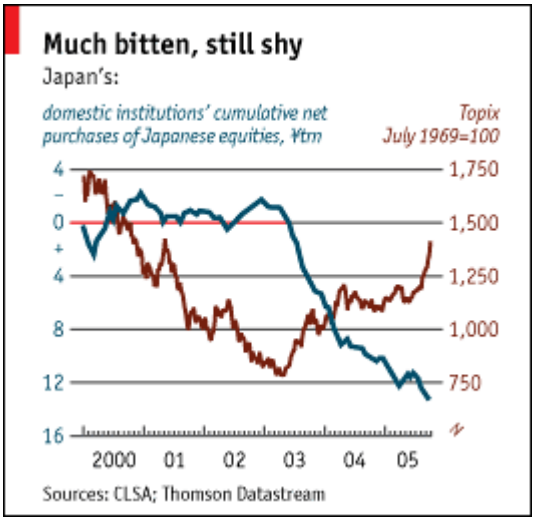
Japanese stockmarkets

The last, best game

Oct 20th 2005 | TOKYO
From The Economist print edition

Foreigners are piling into Japanese shares. The locals aren't so sure

Get article background



THEY'RE back, and the lap dancers approve. Fund managers—from America, Europe and Cayman-registered hedge funds—complain that they can't get a room in Tokyo's swishest hotels. Brokers from the likes of UBS and Goldman Sachs pack their overseas clients into the strip joints of Roppongi. For international money managers, Tokyo—ignored for so long—is the big happy bull-market story. Even golf courses, that great symbol of bubble and bust, are back in the news, as Lone Star, an American investment group and the biggest operator of courses in Japan, says it will float them on the stockmarket. Still, one anxiety is likely to grow: foreign investors' exuberance about Japan is not shared by the locals.

Japanese shares are nowhere near their peak of 1990, at the end of the bubble years. Yet since the market bottomed in the spring of 2003, the Tokyo Stock Exchange's broad-based Topix index has nearly doubled, to four-year highs. It has rallied by a quarter since early summer alone, even if shares have retreated a bit in recent days. The market has been driven up almost entirely by foreigners. Since April 2003 overseas investors have bought an extraordinary ¥22 trillion-worth ($191 billion) of Japanese equities, and now own a quarter of all listed shares. At the outset, hedge funds were the biggest buyers—opportunistic money that presumably might leave as swiftly as it arrived. Recent buying, though, appears to have been by funds taking a long view of Japan's prospects.

It is hard if not impossible to find an economist or equity strategist who has not become markedly more upbeat about that long view. On the political front, the striking win for Junichiro Koizumi, the prime minister, and his Liberal Democratic Party on September 11th underscored a popular desire for the incremental reforms that have begun to roll back the overweening power of the pork-barrel state. Although Mr Koizumi insists he will step down as prime minister next September, his successor will not be able to ignore such a popular mandate. The result, eventually, ought to be a smaller government and a much more flexible economy.

On the structural side, economists say, the baneful consequences of the bubble years are now in the past. The huge overhang of bad debts in the banking system, excess industrial capacity and unproductive labour that held back the Japanese economy for over a decade has now largely been cleared.

Crucially, much of the corporate sector has undergone profound change. Japan's cosy system of

cross-shareholdings has fallen from half of all stockmarket capitalisation at the peak to just one-fifth today, a measure of greater corporate focus. A fall in unit labour costs is a mark of greater labour flexibility. Corporate profits have jumped, to twice what they were at the height of the bubble economy, and are driving an investment boom. Further scope for productivity increases is highly bullish for shares in the long run.

The only thing missing in this upbeat story is a clear end to several years of post-bubble deflation. Yet on October 18th, the Bank of Japan's deputy governor, Kazumasa Iwata, told parliament that the central bank expected consumer-price inflation to be out of negative territory by the end of the year. His comments also signal that sometime in 2006 the bank will cease its ultra-loose policy of "quantitative easing"—essentially, flooding the economy with free money. In anticipation, the price of Japanese government bonds has been falling recently (and their yields therefore rising). In most other countries, this would be seen as bearish for equities. Not in Japan: economists explain the sell-off in the bond market as a return to the proper pricing of money and a more normally functioning economy.

Yet domestic investors continue to be net sellers of Japanese shares. Their appetite for risk, after years of disappointment, does not match that of foreigners. Of households' financial assets, 54% are kept in bank deposits or under the mattress; shares comprise just 8.5%. Although no bear himself, Paul Sheard, chief economist in Japan at Lehman Brothers, says that this caution perhaps remains justified, for deflationary headwinds still blow.

Underwhelmed

One indication is the property market. Residential land prices in Tokyo rose in the first half of this year for the first time in 15 years, but prices continue to fall elsewhere, albeit at a slowing rate. It is hard to imagine households being bullish about shares before they are bullish again about their homes. A second is bank lending. In September private-sector banks lent more (after adjusting for "special factors") than they had a year before, for the second month in a row. And regional banks are starting to lend more again, chiefly to small and medium-sized businesses. Nevertheless lending by the big city banks has still to recover. And once public financial institutions are taken into account, total lending is still contracting.

Given these lingering worries, what the Bank of Japan does next is crucial. Raise interest rates too soon—by next spring, for instance, as some suggest—and Japan's tentative recovery could stall (alas, not for the first time). Households could hold back, either from buying goods and services or from investing in shares. Bear in mind too that a rise in consumption taxes to help plug the budget deficit is a near-certainty for 2007, which will act as a dampener.

True bulls, however, make two points about local investors. Jesper Koll, Merrill Lynch's chief economist in Tokyo, says that the Japanese are already buying shares, but in a way that does not show in official statistics: Japanese brokers, investment trusts and life insurers, with an appalling investment record themselves, are entrusting money to the same hedge funds whose managers are partying in Roppongi.

The second point, made by Christopher Wood, the chief Asian equity strategist at CLSA, an investment bank, is that Japan is in a bull market that could last for years. "The longer the Japanese domestics do not buy, the more inevitably they will buy. And when they do, they will do it all at the same time," he argues. He may be right, but possibly not before some foreigners wonder whether they are setting themselves up for one last fall.

India's markets

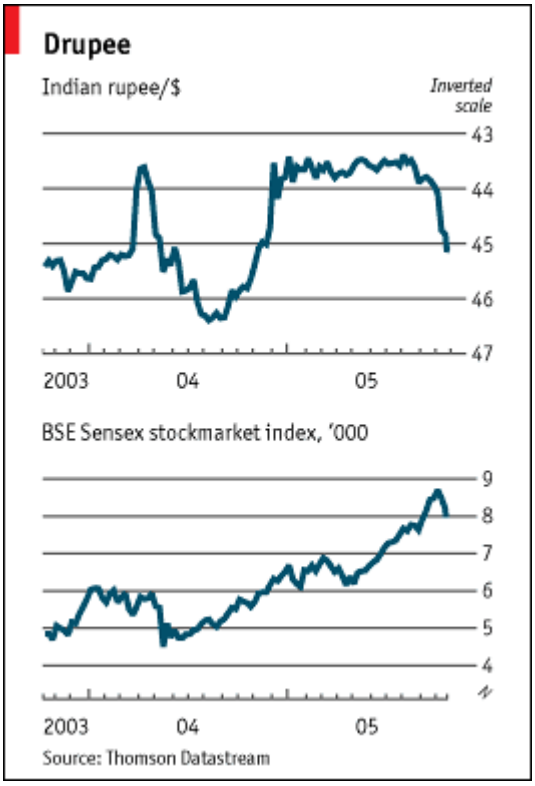
Subcontinental shivers

Oct 20th 2005 | DELHI
From The Economist print edition

Burning markets feel an autumn chill

Get article background

AFTER a scorching summer on India's financial markets, the temperature has plummeted. This week the main stockmarket index, having tested new records for months, was nearly 10% below its historic high, set at the start of the month. The rupee, meanwhile, has been at its lowest against the dollar for nearly a year.



That said, the economy is booming, growing by 8.1% in the year to the second quarter, and shares were still worth over a fifth more than at the beginning of the year. So it is tempting to dismiss the recent setbacks as no more than profit-taking.

They do, however, highlight some worries. The main one is the extent to which India has become dependent on inflows of portfolio investment to finance a current-account deficit. It has long been argued that this in fact reflects a strength. Unlike, say, China's, Indian markets are transparent and well regulated and attract, the argument goes, a better class of portfolio inflow. Still, the speed with which India's external balance is worsening raises questions about its financing.

In the six months to September, India's exports of goods were 21% greater than in the same period last year. But imports were up by a third, to $63 billion. Oil accounted for $21 billion of that, an increase of 43%. India enjoys a big surplus on service trade. Even so, the current account, in modest surplus until last year, was in deficit to the tune of 3.7% of GDP in the second quarter of this year.

That is putting pressure on the rupee, which in turn is one reason why foreign investors—especially from Japan—have been taking their money out of the stockmarket. Between January and September, foreigners bought a net $8.5 billion-worth of Indian shares, nearly as much as in all of 2004. But in the first 20 days of October, they pulled out a net $280m—hardly a stampede, but enough to compound the weakening of the currency.

In the short term, the central bank, the Reserve Bank, may actually welcome depreciation. It has built up a big stock of foreign-exchange reserves, some $140 billion, to prevent the currency rising too sharply. In July, after China had tinkered with the external value of the yuan, the rupee was at a six-year high against the dollar. Indian exporters have been moaning about the damage to their

competitiveness.

Price competition from imports and the government's refusal to pass on rising oil prices in full have helped to keep inflation in check. Now the breakneck pace of growth, coupled with loose monetary policy, is causing the inflation rate to climb. The wholesale-price index, the measure most widely used, was showing an annual increase of 4.2% at the beginning of October, up from about 3% a month earlier. Many analysts argue that this index understates inflation, and that the Reserve Bank will soon find itself forced both to intervene more forcibly to stem the decline in the rupee and to raise interest rates when they are reviewed next week.

Some hedge-fund managers have long been eyeing India for signs of a vicious circle of share sales by foreigners and a weakening rupee. For the time being, such talk looks overblown. India's growth is so strong, and so many of its companies are doing so well, that it must remain one of the most attractive of emerging markets. The danger, however, is that as monetary conditions tighten in America, Europe and Japan, the global flows of capital that have swollen share prices in emerging markets go into reverse. India might then find its portfolio inflows are as volatile as everywhere else's.

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Economist.com FINANCE & ECONOMICS

Managing Harvard's endowment

Hard act to follow

Oct 20th 2005
From The Economist print edition

A new helmsman for the world's biggest university endowment

WITH its AAA credit rating, tax-exempt status and long-term investment outlook, the Harvard Management Company (HMC)—the body that invests that university's $25.9 billion endowment—is not a bad berth for an asset manager. Even so, the job of running HMC has proved hard to fill. This is perhaps the result of alumni disgruntlement at performance bonuses paid in the past to the fund's managers and of the subsequent lowering of a cap on their pay.

Harvard did not find a replacement for Jack Meyer, incumbent for 15 years, before he left to found a hedge fund on September 30th. At least one candidate turned the job down. But on October 14th, the university named a surprising successor: Mohamed El-Erian, manager of a $28 billion debt portfolio at PIMCO, a fund-management firm specialising in bonds.

Mr Meyer, who took three top bond managers and HMC's chief risk officer with him, was spectacularly successful. On his watch, the value of Harvard's endowment quintupled, outperforming all other universities' funds. The institution became one of the world's richest non-profit organisations.

Mr El-Erian, half-French and half-Egyptian, Oxford- and Cambridge-educated, spent a long while at the IMF, where he impressed many in successful negotiations with Mexico and Pakistan. In 1999, he took over PIMCO's emerging-markets bond fund, and has piloted it to the second-best record in its peer group since then, largely thanks to his exit from Argentine debt before that country's default and to his faith in Brazil's solvency when many doubted it in 2002. “He just has been willing to be a lot more daring and go his own way,” says Arijit Dutta, an analyst at Morningstar.

But Mr El-Erian's six years at PIMCO represent his entire direct-investment experience. His portfolio consists wholly of fixed income securities, which comprise just 22% of Harvard's endowment. Though widely praised for his diplomacy at the IMF, Mr El-Erian was less diplomatic as a fund manager. His style—using the portfolio's size to wield formidable influence in the market for developing countries' debts—ruffled feathers both in finance ministries and on Wall Street.

Mr El-Erian has also irked some hedge-fund managers by blaming them for excessive volatility in emerging markets. He may have to make more friends among them now, given Harvard's hefty stake in hedge funds and the possibility that he will have to recruit from their ranks—already a daunting task, given HMC's high visibility and limited compensation. “It's as difficult for Harvard to attract people from hedge funds as anything I've ever seen in the investment world,” says James Rothenberg, the university's treasurer.

HMC, says Mr Rothenberg, has bags of experience in equities and commodities to go with Mr El-Erian's focus on bonds. Mr El-Erian sees himself as “a player-coach, playing a certain position and coaching others”. Still, even if more talent can be lured, it will be hard to match Mr Meyer's record. Most analysts expect returns to drop across the board in the next decade; and some of Harvard's old advantages, such as its credit rating and ability to take illiquid positions, may matter

less. The moans of alumni over managers' pay may be replaced by grumbles that Harvard's astonishing run is coming to an end.

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Economist.com FINANCE & ECONOMICS

Nigerian debt

Clean slate

Oct 20th 2005
From The Economist print edition

Africa's biggest debtor reaches agreement with its rich-country creditors

Get article background

AP

Mrs Okonjo-Iweala sealed the deal

THE 34 billion barrels of oil reserves lying beneath the swamps and seabeds of Nigeria are the result of millions of years of geological pressure. Political forces nearly as strong resulted this week in something almost as prized: a deal to forgive about 60% of the $31 billion the country owes to the Paris Club, an informal group of rich-country governments.

In the past, Nigeria's black gold has proved an obstacle to erasing its red ink: why should its creditors forgive the liabilities of a country blessed with such a valuable natural asset? But Nigeria's recent oil-revenue windfall, much of which is sitting in its central bank's vaults, has lubricated this week's deal.

The country will draw on its $26 billion of reserves to clear its arrears with its Paris Club creditors, which amount to about $6 billion. In about six months' time, it will then offer to buy back all of its remaining Paris Club debt at 24 cents on the dollar, an offer worth another $6 billion or so. All in all, then, Nigeria will repay about $12 billion of the $31 billion it owes the Paris Club.

In the meantime, Nigeria must preserve the rough macroeconomic stability it has won in the past 18 months. Normally, any country that pleads forgiveness before the Paris Club must first accept the charity and chastity of a full IMF programme. But the Fund has an unfortunate reputation in Nigeria. So the IMF will monitor the country's progress at one remove, using a new “instrument” it has invented for the purpose, and without offering any money.

As Lex Rieffel, of the Brookings Institution, points out, Nigeria's commercial creditors forgave much of its debt as long ago as 1992. But the Paris Club governments were more fussy. They did not want to deal with General Sani Abacha, in power between 1993 and 1998, and he did not want to deal with them. In the past couple of years, much has changed. Nigeria's forceful finance minister, Ngozi Okonjo-Iweala, has sought to redeem Nigeria's woeful reputation in the centres of financial power, and the country's biggest creditor, Britain, has been equally keen to demonstrate its commitment to fighting poverty in Africa. The offer of $12 billion did the rest.

The buy-back puts cash in the hands of creditors, who grew accustomed over the years to receiving precious little from Nigeria. It also has political virtues, according to Todd Moss of the Centre for Global Development, the Washington think-tank that first proposed the buy-back. In the past, he points out, Nigeria's oil windfalls have been squandered. Therefore it is better to spend this money now, by paying off future obligations, than to leave it piling up in the central

bank, as an open invitation to irresponsibility. Oil money is here today, mis-spent tomorrow. Debt relief is for ever.

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Economist.com FINANCE & ECONOMICS

Economics focus

A foreign affair

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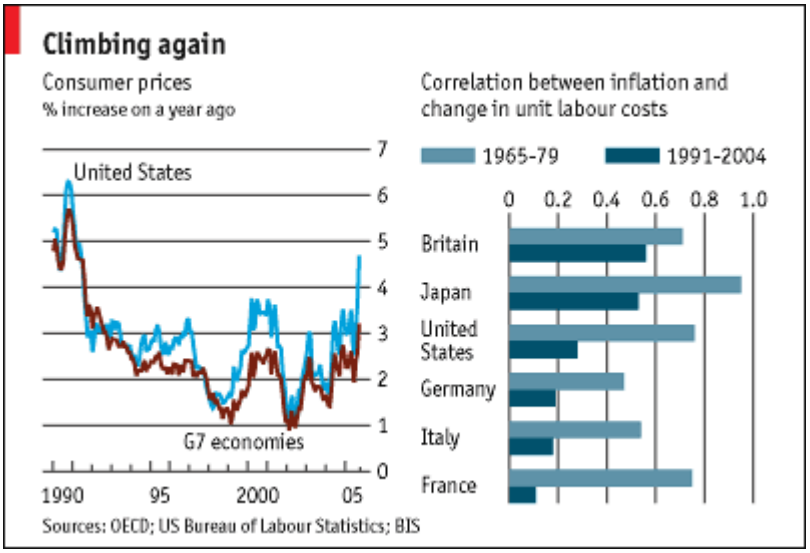
Inflation is increasingly determined by global rather than local economic forces

THE average inflation rate in the G7 economies rose to an estimated 3.2% in September, its highest for 13 years. The main reason for the return of inflation is that oil has become a lot more expensive; “core” inflation rates, which exclude oil and food, remain much lower in all countries. But fears are mounting that higher oil prices will feed into other prices throughout the economy, pushing inflation higher still.

This is particularly worrying for America. On top of soaring oil prices, companies' unit labour costs rose by 4.2% in the year to the second quarter, mainly thanks to slower productivity growth. The rate of growth of these costs increased by more over the year than at any time for two decades. With energy and labour becoming conspicuously dearer, any inflation model based on a mark-up of prices over costs should be flashing red. Yet in the past year core inflation has not budged. How come?

Stephen Roach, chief economist of Morgan Stanley, suggests that thanks to globalisation, the inflation process has changed over the past three decades in a way that has significantly weakened the link between domestic cost pressures and inflation. He draws on an analysis in the latest annual report of the Bank for International Settlements (BIS), which suggests that global forces have become more important relative to domestic factors in determining inflation in individual countries.



According to the BIS, the correlation between core inflation and the growth in unit labour costs in

America fell to only 0.3 in 1991-2004, from nearly 0.8 in 1965-79. The link between inflation and labour costs also faded in other developed economies (see chart). This probably reflects two things. First, the integration into the world economy of China and other emerging economies with vast supplies of cheap labour has curbed the bargaining power of workers in developed economies. These workers therefore find it harder to secure higher wages when inflation picks up. And second, fiercer global competition has made it more difficult for firms to pass increases in wages through to prices. Instead they must absorb them in their profit margins.

As further evidence that firms are less able than they were to hand cost increases on to their customers, the BIS found that fluctuations in import prices also have much less impact on core inflation than they once did. Similarly, the link between movements in exchange rates and import prices has sharply diminished. Standard economic theory has it that a fall in the dollar against the euro should push up the dollar prices of European exports to America, raising America's inflation rate. But the proportion of exchange-rate changes passed through to import prices has fallen everywhere; in America, it has been 60% lower since 1990 than it was in the previous 20 years. Today, exporters set their prices for a local market and then either hedge their currency risk or absorb currency changes in their margins.

Increased global competition has thus limited the room for firms to pass on higher costs. This makes a nonsense of traditional economic models of inflation, which virtually ignore globalisation and assume that companies set prices by adding a mark-up over unit costs, with the size of the margin depending largely on the amount of slack in the economy. In reality, when setting prices firms are increasingly likely to be constrained by global competition. Given the price the market will bear, they design and make their products as profitably as they can. As a result, domestic cost pressures, whether in labour or energy, no longer lead automatically to higher inflation, but are more likely to show up as swings in profit margins.

This suggests that in forecasting inflation central banks now need to pay less attention to domestic shifts in unemployment and capacity utilisation and much more to the global balance between supply and demand. The BIS's research shows that since 1990 the core rate of inflation has become less responsive than it used to be to changes in the output gap (a measure of economic slack) in all the main developed economies except Britain. The ups and downs of inflation increasingly reflect the global balance between supply and demand.

A premature obituary

The nature of inflation has thus changed. But it has not died, although the forces of globalisation have helped to combat it. Policy blunders by central bankers could still allow it to break out again. Indeed Don Kohn, a governor of the Federal Reserve (and one of several potential successors to Alan Greenspan as chairman), reckons that the impact of China and other newly industrialising economies on inflation is often exaggerated. In a speech last week, he drew on a Fed study which concluded that the direct impact of cheaper Chinese imports on American inflation was modest. However, this study ignored the indirect effects of China on wages and the fact that cheaper Chinese goods do not just reduce the price of imports from China but, through competition, the price of all goods sold worldwide.

Mr Kohn may well have underestimated the extent to which globalisation has borne down on inflation in past years. However, more important for policymakers today is its future effect. As Mr Kohn argued, the emergence of new industrial giants has increased not only global supply but also demand, particularly for oil and other raw materials. By running large current-account surpluses these economies are currently adding more to supply than to demand, so their net effect is disinflationary. But this could change. If their exchange rates rose and their domestic demand increased, said Mr Kohn, downward pressure on prices would ease, and might one day be

reversed.

Even though globalisation has helped to hold down inflation so far, capacity constraints will eventually appear in the global economy, just as they always have at the national level. Globalisation does not relieve central bankers of their responsibility for maintaining price stability. But it may require them to steer policy by a different compass: one that takes much more account of developments abroad.

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Avian influenza

In a flap

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From The Economist print edition

AP

Alarm over bird flu has focused attention on preparing for a human version

HOWEVER much fear there is over bird flu spreading in Asia and Europe, at present the disease tends to make birds sick and not humans. This may change, and some countries are preparing for a pandemic of human influenza. This is wise, given the huge costs of having a significant fraction of the workforce off sick or nursing relatives. But the best way of preventing a human pandemic might be to monitor and limit the spread of bird flu.

The particular strain of bird flu currently circulating began in South Korea in 2003. It is the largest and most severe outbreak on record. Millions of birds have caught the disease and 150m poultry have been culled. Despite this action, the virus is now endemic in many parts of Indonesia and Vietnam, some parts of Cambodia, China and Thailand, and possibly Laos. Yet only 117 people have caught the virus because it is difficult to catch. In the unlikely event it is caught, it is highly lethal. More than half those infected, 60 people, have died. Those most at risk are poultry workers in these countries, their families and those working with wild birds.

The broader problem, and the reason for worldwide alarm, is that animal diseases often become human ones. This strain of bird flu—the highly pathogenic H5N1—could well become something particularly nasty to humans. The virus can infect and kill a range of other mammals, including those which were previously considered resistant to infection by avian influenza. With H5N1 endemic in some countries, there is a continual possibility that the virus could mutate into a full-blown human disease.

Should the virus turn into something easily transmitted between humans, it would be likely to

infect a large proportion of the world's population, as few people would be immune to such a novel strain. There is no way of predicting how dangerous it would be. But because a large proportion of the population would be vulnerable, even a low fatality rate could mean millions of deaths. And there is historical evidence that just this sort of thing happens three or four times a century.

If a new influenza virus were to cause only a mild disease, projections from the 1957 pandemic suggest it would cause between 2m and 7.4m deaths. Recent evidence suggests that the less severe pandemics in the second half of the last century, in 1957 and 1968, were caused by a human flu virus that had swapped genes with a bird flu virus. The more serious 1918 pandemic was caused when a bird flu virus adapted on its own to become transmissible between humans. The mortality rate was about 2.5% and 40m-50m died.

While neither the severity nor the timing of the next pandemic can be predicted, the spread of bird flu increases the probability it will happen. Many people—including Rajeev Venkayya, the senior director for biodefence at the White House—give warning that a major pandemic is overdue. If one happened this year, the world's ability to respond would be limited. Thus, the sprint to prepare for a pandemic is under way.

When human influenza begins to spread internationally, it is considered unstoppable. The disease spreads rapidly by coughing and sneezing and through direct contact, so regular hand washing is important to prevent infection. However, because infected people can spread the virus before they show symptoms, it will not be possible to use quarantine to halt its spread. Past pandemics, in less globally connected eras, have taken six to nine months to complete their global passage. There was nowhere to hide.

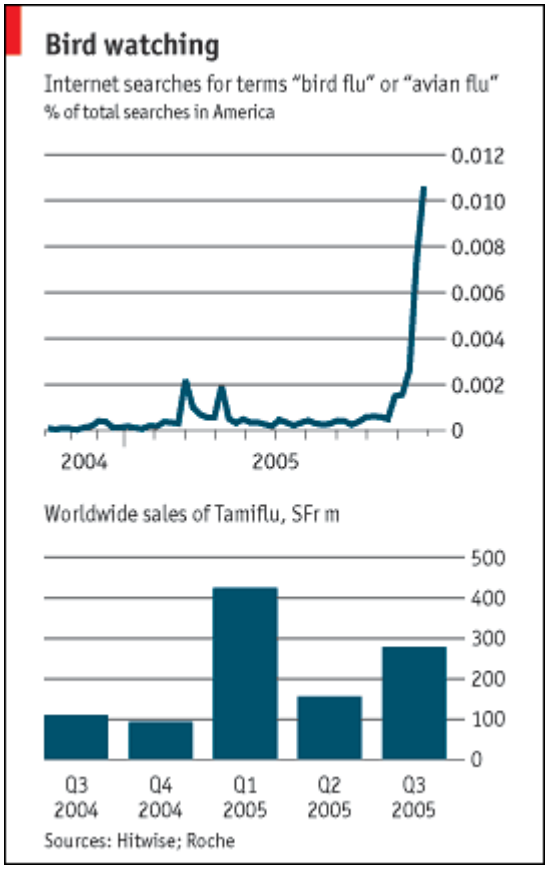
Although the 1918 mortality rate was low, lots of people died because so many people caught the virus. During pandemics, there are large surges in the number of people needing medical treatment, and health services quickly become overwhelmed. Many stay at home, either because they are ill or because they need to look after dependants who are ill, so disruptions can occur to essential services such as the police, transport and communications. Furthermore, many countries are likely to experience emergency conditions simultaneously, so international assistance could be limited.

The best preparation against an existing pandemic would be to produce a vaccine quickly and in sufficient quantities to protect people soon after the pandemic strain of virus emerged. Unfortunately, this is not yet possible. If an outbreak were to happen tomorrow, it would take four to six months to produce a vaccine. Even then, there would only be enough for those at greatest risk, such as health-care workers, pregnant women and asthmatics. Without a way of stretching vaccines, they will also be restricted to a small number of rich countries. Work is under way to change this, but it will take time.

Another option is to use anti-viral drugs in the event of an outbreak. They can be taken continuously to prevent infection, or given to the infected to reduce the severity of their symptoms and associated complications, perhaps saving their lives. Anti-viral drugs such as Tamiflu (oseltamivir) and Relenza (zanamivir) reduce the duration of illness caused by seasonal influenza if taken within 48 hours of symptoms appearing. It is thought likely they would do the same for pandemic influenza. But it is Tamiflu that is the drug of the moment, because it is a convenient tablet while Relenza is a dry powder that must be inhaled—and inhaled correctly. There are other, older, anti-viral drugs available—amantadine and rimantadine—but any emerging influenza is more likely to develop resistance to these drugs.

As countries have started to plan for a pandemic, many have begun stockpiling Tamiflu. It is expensive. But a study by Ran Balicer and colleagues at the Israeli

Ministry of Health, published in August in *Emerging Infectious Diseases*, concluded that in Israel it was worthwhile at 2004 prices to stockpile Tamiflu not just for essential workers, but for all patients. What makes the study's conclusions more plausible is that the authors used very conservative assumptions, only counting the direct costs to the health system and lost workdays of a pandemic. They omitted wider indirect costs of disruptions to the economy and the value of lives saved—other work shows this is 83% of the benefits of fighting a pandemic. Dr Balicer argues that sizeable Tamiflu stockpiles are worthwhile even if a pandemic comes only once every 80 years. Most scientists believe that the next pandemic will come far sooner than that.



Yet, at current rates of production, some reports suggest it would take Roche, the Swiss drug firm that makes Tamiflu, a decade to produce enough to treat 20% of the world's population. Such is the demand for this drug that there is now a worldwide shortage and Roche appears to be bowing to pressure to allow other companies to produce it. There are signs of impatience everywhere. Researchers in Taiwan have just announced they have been trying to replicate the drug for the past few months. Cipla, a manufacturer of off-patent drugs in India, says that it plans to supply the drug cheaply next year. Thailand and Argentina, too, have warned they will bypass Roche's patent and make their own versions of the drug.

The shortage of the drug is particularly acute in America. It has Tamiflu for less than 1% of its population, while France has enough for 24%. Earlier this year, the Infectious Diseases Society of America said the nation's stock of anti-viral medicine was "totally inadequate and unlikely to provide any meaningful benefit". Today, with Katrina-tinted spectacles, America wants to prepare but must wait at the end of a long line for its supplies. Countries that have disclosed orders for Tamiflu include Britain, the Czech Republic, Hong Kong, Singapore, South Korea and Thailand.

The World Health Organisation (WHO), which has been trying for years to attract attention to the threat posed by influenza pandemics, has called on governments to update their pandemic plans to minimise the health consequences. So far, only a small number of countries have done so. National plans cover topics such as who will be first in line for treatment, how to keep essential services running and when it might be a good idea to prevent public gatherings and close schools to slow the pandemic's spread.

Some of the countries with well-developed plans, such as Canada and Australia, were in the front line of the effort to stop the spread of severe acute respiratory syndrome from Asia in 2003. SARS—which was not as infectious or virulent as influenza—was limited to 8,000 infections; one in ten died. But it still cost an estimated $60 billion in lost output to South and East Asia because people cut back on travelling and shopping.

Again, notably, America has not published a plan, and there is confusion over when one might be produced. Earlier estimates suggested a pandemic could cause 89,000-207,000 deaths in America, but a draft plan leaked recently suggested 1.9m. The challenges are great, given that the country lacks a co-ordinated public-health system and 40m people have no medical insurance. The links between federal, state and local government are also weak.

Widespread alarm over bird flu is now focusing minds. Robert Shapiro, formerly Bill Clinton's economic adviser and now chairman of Sonecon, an economic advisory firm in Washington, DC, has been looking at the economic consequences of epidemics. He found that epidemics only have a big economic effect if they are pervasive and protracted.

So a pandemic that will make a lot of people sick over a long period of time is something to worry about. Mr Shapiro also warns that physically small and less well-developed countries, such as South Korea and Vietnam, are more vulnerable because the effects of a pandemic will be more pervasive there. But big countries have plenty to worry about, too. One study suggests that, if 15% of the American population were to fall ill, the economic cost might amount to $93 billion. If 35% were to succumb, the cost would rise to $217 billion. These figures include health-care costs, lost workdays and the lost earning potential of the dead.

No wonder businesses are fretting about disruptions to travel and trade. Furthermore with the use of more overseas suppliers and “just-in-time” supply chains, some firms worry that their operations could be brought to a standstill even if enough of their own employees make it to work. As for the costs, companies themselves would have to shoulder them. Aon, an American insurance broker and risk consultant states, “broadly speaking, a pandemic will be an uninsured event.” Employee shortages are likely and Aon suggests that companies should assume 25% of workers could fall ill.

The top priority for everyone from scientists such as Klaus Stohr, who leads the WHO's global influenza programme, to economists such as Paul Gertler, at the World Bank, is better surveillance and prevention. Mr Shapiro, too, adds that “with sufficient resources, which are frankly trivial for an international effort, we could spend $250m-500m on an effective system of monitoring and rapid response to an outbreak in Asia.”

Computer models suggest that the WHO's global stockpile of Tamiflu (about 3m doses) could be deployed to the site of first emergence of a pandemic strain and used to eliminate it at source. However, the outbreak has to be detected within 21 days to have a chance of working. Close surveillance is vital to check that bird flu is not mutating into a human form.

The problem with surveillance is that some countries, such as Cambodia and Vietnam, lack the infrastructure needed to do it effectively. Even in countries that should be able to monitor the virus, such as China and Russia, the extent to which they are doing so, or are disclosing how far bird flu has spread, is open to doubt.

China's handling of bird flu has been characteristically secretive. It has not provided virus samples in spite of repeated requests from WHO officials. It has reported four outbreaks of bird flu this year (Qinghai in May, two in Xinjiang in June and Tibet in August) but no human cases, which has aroused some scepticism. It was sluggish about giving WHO officials access to affected areas. Part of the problem could be bureaucratic: the Ministry of Agriculture rather than the Ministry of Health is responsible for animal monitoring.

Reuters

Stalking horse

During a tour of South-East Asia last week, Mike Leavitt, America's health secretary, pledged support for an international surveillance network to quickly determine when the current strain of bird flu evolves into a virus that could spread rapidly between humans. More international co-operation and planning of this sort will be high on the

agenda at a meeting of health ministers in Canada later this month. But if countries with avian influenza are to be persuaded to open up to surveillance and co-operation, they will want rich countries to loosen the purse strings for better diagnostics, anti-viral drugs and aid for veterinary and health facilities.

The most effective way to prevent a human pandemic would be to control any outbreak in domestic birds (the disease cannot be stopped in wild birds). Containing this disease would also make economic sense for the poultry industry and the many farmers in poor countries with smallholdings of ducks, geese and chicken that are a crucial part of the food supply but vulnerable to the H5N1 virus.

The United Nations Food and Agriculture Organisation (FAO) has called on countries on the flight paths of wild birds to set up warning and surveillance systems. These include northern Africa, the Middle East, Central Europe, India and Bangladesh. In such places, people live more closely with poultry, and the arrival of bird flu is cause for concern because it could lead to many new human cases.

In Europe, surveillance and veterinary health care are good, so the opportunities for infection of poultry workers (and subsequent mutation of the virus) are limited. Similarly, outbreaks of H5N1 in Japan, North Korea and Malaysia were quickly brought under control and are now believed to have been eradicated.

In an outbreak of H5N1 in Hong Kong in 1997, the territory acted quickly to destroy 1.5m chickens, virtually its entire stock. This action undoubtedly prevented an expensive regional outbreak until H5N1 emerged again in 2003. It may also have prevented a human pandemic. If the world is to keep the threat at bay, more painful sacrifices like this will be vital.

For that, some kind of global fund would be helpful to encourage culling, monitoring and the correct use of animal vaccines. The FAO estimates that $175m is needed to begin tackling the problem of avian flu at source by setting up control programmes. To date, $30m has been pledged but the World Bank and the European Commission are expected to invest much more in the control of flu through vaccination and better monitoring.

In the longer term, technological advances, if they are pursued, could reduce the threat of a pandemic, and the cost of containing and responding to one. The ability to stretch vaccines further might not be far away, increasing their supply once they are available. It is possible, too, that some other cheap drug will be found that reduces the chances of fatal complications. Some recent research has indicated that statins, of which there are plenty, may be able to do this. And in five years (possibly much less, with effort) it is possible that the technology for producing flu vaccines will be transformed. Two companies, PowerMed and Vical, are working on flu vaccines that can be cooked up quickly in vats instead of being grown laboriously on eggs. Hundreds of millions of doses could be made in as little as three months by cheap automated factories. There are other possibilities and drugs on the horizon, too. Maybe one day, influenza will be a horror of the past and not of the future.

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Agriculture

Going bananas

Oct 20th 2005
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A banana bank is safeguarding the future of the crop

BANANAS, like their cousins, the tropical staples cassava and taro, have a characteristic that makes them ideal food. They have no seeds. Unfortunately, the same characteristic means that it is fiendishly difficult to breed better bananas. This is an important task, as bananas are threatened by new kinds of pests and diseases. Furthermore, because bananas are clones, whole plantations could be devastated by such an attack.

EPA

Yes, we have bananas—but for how long?

The United Nations Food and Agriculture Organisation estimates that bananas are the fourth most important crop in the world, after wheat, rice and maize. For around 400m people in the tropics, bananas are their most significant staple food. Some 90% of the world's harvest of bananas are grown on small farms in developing countries and much of this crop is eaten by people who live locally. The export trade, meanwhile, is worth some $5 billion a year.

Bananas are vulnerable to pestilence and disease because they reproduce asexually. Before they became domesticated crops, wild bananas were inedible fruit stuffed with stony seeds. Edible varieties probably first arose as random, sterile mutants. Farmers propagated these varieties by taking cuttings from suckers that grow from the base of the parent plant.

This week, Leuven in northern Belgium was celebrating its unlikely role as the world's banana capital. The Catholic University of Leuven hosts the world's largest collection of banana diversity. Over the past 20 years, some 1,175 different kinds of banana have been carefully nurtured as tiny plants growing in test tubes. This *in-vitro* storage is expensive, because even when kept in cooler, darker and less nutritious conditions than normal, banana plants still outgrow their test tubes every few months. The plants had to be cut back and replanted, which took skilled labour.

Researchers at the university have now developed ways of deep-freezing banana samples. They have demonstrated that, after five years of being plunged into liquid nitrogen, banana cell suspensions can be recovered and turned into growing plants.

The most successful methods for improving the banana through genetic engineering rely on the availability of embryonic cell suspensions. Getting these is tricky, but the researchers hope that cryopreservation—that is, deep-freezing at extremely low temperatures—will preserve them indefinitely, once they have been obtained. As part of an agreement signed this week with the International Plant Genetic Resources Institute, the university will train scientists from developing countries in *in-vitro* and cryogenic techniques.

Breeding better bananas is important because bananas are so vulnerable to disease. In the 1950s, commercial plantations all grew one variety of banana, called Gros Michel. It was, by all accounts, a superior-tasting fruit to today's supermarket stocks of the Cavendish variety. The Gros Michel banana still grows in the more remote parts of Uganda and Jamaica. Elsewhere, it was wiped out by Panama disease, a wilt caused by a fungus called fusarium. This devastated the large commercial plantations that fed the export trade.

In 1992, the disease mutated into a form that is able to attack the Cavendish variety. Plantations in Malaysia were wiped out. At present, the disease is confined to Asia, but experts fear that it is only a matter of time before it reaches Latin America and the Caribbean.

Creating disease-resistant hybrids is thus a matter of some urgency. In addition to the traditional varieties, generated by natural mutations, a few such strains have been created by transferring genes directly from one variety to another. These are currently being tested in Uganda and Tanzania. It may prove possible to create a tasty banana that is resistant to Panama disease. Those who depend on bananas will hope the researchers do not slip up.

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Cosmology

Much ado about nothing

Oct 20th 2005
From The Economist print edition

A controversial new calculation suggests dark matter might not exist

THE adage “what you see is what you get” could be thought to ring true for a group of people who dedicate their lives to collecting tiny flickers of light from very distant objects. But astronomers and cosmologists, who do exactly that, have long held that the universe is pervaded by far more than that which can be seen. Since the 1930s, they have postulated the existence of “dark matter”, an ethereal and, as yet, undetected form of matter.

Physicists claim to need dark matter to explain why the stars in the outermost reaches of rotating galaxies are moving at such great speeds. If these galaxies consisted only of the stars that can been seen, their gravity would be insufficient to hold on to the outermost stars. The individual stars would simply fly out of the galaxy, like a doll thrown from a rapidly spinning merry-go-round. Thus, the galaxy must contain some mysterious matter that makes it massive enough to keep hold of these stars.

Such matter would pervade the entire universe. According to standard cosmological models, 20-30% of the mass of the universe must consist of the stuff. Such matter does not absorb or give off light, and is extremely difficult to detect. None of the large underground experiments that have been designed to catch a glimpse of it has yet seen anything.

Now, in a controversial paper that has recently appeared on arXiv, an online collection of physics papers, Fred Cooperstock and Steven Tieu of the University of Victoria in Canada claim that one of the key pieces of evidence for the existence of dark matter is not really there.

Instead of using Newton's theory of gravity to examine why fast-moving stars remain within their galaxies, the pair applied general relativity, Einstein's theory of gravity, to the problem. Einstein's theory holds that matter and energy distort space, and massive bodies such as planets and stars travel in this warped space. The theory supersedes Newton's law in situations where gravity is very strong, such as next to a black hole, or where energies and speeds are very high. But neither applies to the case of stars orbiting the outer reaches of a galaxy.

The key, Dr Cooperstock claims, is a “non-linearity” that arises in Einstein's theory. If one body is much larger than its neighbours, such as the sun compared with the planets of the solar system, its effect dominates the others. But when all the bodies are very massive, such as stars in a galaxy, this non-linearity becomes important. Each star strongly influences—and is influenced by—the rest.

To their surprise, when he and Mr Tieu did the calculation with general relativity, they found that they were able to reproduce the observed speeds at which individual stars are orbiting the centre of a galaxy, without requiring the galaxy to contain dark matter. Indeed, the distribution of mass through the galaxy roughly followed the distributions of visible matter, with no need for exotic new particles.

However, most physicists and astronomers remain unconvinced. They point to a body of other evidence for the existence of dark matter. The way distant light is bent around galaxies hints that they should have more mass than can be seen. So do measurements of how the largest-scale structures in the universe formed over time and of how clusters of galaxies are held together. Furthermore, a follow-up paper by Mikolaj Korzynski of Warsaw University in Poland has claimed that there is a fatal flaw that may make Dr Cooperstock's model a mathematical but not a physical possibility.

Dr Cooperstock says that he is preparing a detailed response. After giving the scientific community a chance carefully to consider his model, he plans to submit the work to the *Astrophysical Journal*.

“We just cut off this piece. It is part of the puzzle,” Dr Cooperstock says. At worst, the piece will not fit and his model will turn out to be incorrect. In that case, though, physicists will have gained a better understanding of how the predictions of general relativity mesh with Newtonian gravity in the case of galaxies. The assumptions on which the existence of dark matter are based will thus rest on stronger foundations. At best, Dr Cooperstock's model will stand up to scrutiny. Then, for galaxies at least, it will turn out that there is not much more to them than meets the eye. In either case, physics will be the better for it.

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It's time to go on a low-carbon diet.

The Soviet army

Blood meridian

Oct 20th 2005
From The Economist print edition

A new history exposes Russia's wartime agony from the bottom up

Ivan's War: The Red Army 1941-1945
By Catherine Merridale

To be published in America by Metropolitan Books in January
Faber and Faber; 374 pages; £20.

Buy it at
Amazon.com
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Corbis

WHAT was the second world war like for Russian soldiers? That simple question has a complex answer. Soviet official accounts overlaid the real human, political and military history of the war with a thick layer of gooey, self-congratulatory myth. There are tales of comradeship and heroism aplenty, but little that tells a modern-day reader what the greatest war in history was really like.

Catherine Merridale, a British historian, has picked the locks that kept this history hidden. Through hard work with official archives, diaries, letters and hard-won interviews with veterans, she brings to life the soldiers' war: the chaos and panic of the retreat before the German onslaught, when up to 3m Soviet troops were taken prisoner; the brutal punishment of deserters and their families; the early days of the war when shortages of equipment, clothing and munitions were matched by relentless sloganeering and political meddling; the epic drunkenness and black marketeering; and the orgies of destruction and cruelty on both sides.

Obtaining first-hand accounts of all this required skill and perseverance. The “Great Patriotic War”, as Russians still call it, has such a sacred place in the national mindset that any questioning, particularly by a young foreign woman, would have struck many people as indecent.

The result is essential reading for anyone who wants to understand the history of the time, or modern Russia's dependence on it. Ms Merridale's earlier book, “Night of Stone” (2000), was a definitive account of the Russian attitude to the death and suffering that drench its history. Now her feel for human nature and her excellent knowledge of Russian language and culture, combined with her research among Russian (and German) sources, have produced a worthy sequel.

Whereas other historians have focused recently on the salacious details of life at the top of Stalin's Soviet Union, Ms Merridale's approach is from the bottom up, coupled with her own careful but incisive analysis. She illuminates one of the great puzzles: what Russians really thought of Stalin. Even under the Terror, his personality and Soviet patriotism fused to inspire not just fear, but respect as well as a kind of love. People survived, she writes, by “evolving to fit the framework of a monstrous state. It was far easier, even the doubters found, to join the collective and share the dream than to remain alone, condemned to isolation and the threat of death.” When the war started, Stalin retreated from public view. One soldier quoted in the book, Ivan Gorin, laughed when asked if soldiers really yelled in unison “For the motherland, for Stalin” (as the official myth says) before going into battle. “I'm sure we shouted something when we went to the guns. But I don't think it was that polite.”

Ms Merridale highlights the increasingly savage response of the authorities when defeat loomed after Hitler's surprise attack. The state's answer, she writes, “was to prepare a war against its own people. If they would not behave like epic heroes of their own accord, then NKVD guns would force them to.”

Eventually, that changed. Political commissars were reined in, and professionalism returned. In a telling passage, Ms Merridale describes the return in 1942 of proper training and military ethos to the army. Drill replaced “comic-strip heroics”, she writes. “There would be no more suicidal leaping on to the barricades, no more distracting competitions to see which unit could march fastest or form into the straightest line.” The authorities brought back medals, and even officers' epaulettes—which before the war had been a hated symbol of tsarist privilege. Some soldiers hoped, vainly, that the next step might be the abolition of collective farms.

For all her efforts, some details of life in the Red Army are as unremembered now as they were unrecorded then. Nobody wrote down the unofficial songs, the jokes or the slang, and veterans find it hard to disinter them from memories overlaid with decades of official pomp and invention. Ms Merridale has a bit more luck in plumbing the darker depths—the rapes, destruction and looting that the Red Army meted out, first on the countries seen as having collaborated with Hitler's Reich, and then on Germany itself. “Rape combined the desire to avenge with the impulse

to destroy, to smash German luxuries and waste the fascists' wealth. It punished women and reinforced the fragile manliness of the perpetrators.”

The blandness of many soldiers' memories, though they were vivid raconteurs when they talked of life outside the war, seemed puzzling. Ms Merridale came to see it as a secret of their resilience. “The path to survival lay in stoical acceptance.” Sadly, that stayed true for some time. As she notes, “The motherland was never conquered, but it had enslaved itself.”

Ivan's War: The Red Army 1941-1945.
By Catherine Merridale.
Faber and Faber; 374 pages; £20.
To be published in America by Metropolitan Books in January

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It's time to go on a low-carbon diet.
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bp beyond

The Mitrokhin archive

Pilfered piles

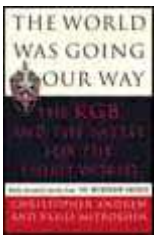
Oct 20th 2005
From The Economist print edition

THE story of the late Vasili Mitrokhin is rather more remarkable than the story he tells. As an archivist in the foreign intelligence service of the Soviet Union, he was in charge of shifting the KGB's most secret documents from the old headquarters in central Moscow to a new skyscraper on the southern outskirts of the city. It was a job for someone totally loyal to the system. But Mitrokhin wasn't. He had turned into a staunch anti-communist early on in his career, and he vowed to copy down all he could in the hope of, one day, doing the Kremlin as much damage as he could.

Which he did, thanks to a diplomat at the newly re-opened British embassy in Riga in 1992, to whom a scruffily dressed Mitrokhin offered a sample of his archive. The rest is history, of a kind. With an ingenuity and daring worthy of—or in truth rather better than—their fictional counterparts in the novels of John le Carré and Ian Fleming, officers of Britain's Secret Intelligence Service (SIS or MI6) retrieved the huge cache of documents buried beneath Mitrokhin's country cottage.

That, we are told, dealt a devastating blow to the KGB's remaining cold-war assets. It included details of operations old and new, and the “crown jewels”—lists of undercover agents living in the West under carefully constructed secret identities. But the Russian spymasters could not be certain exactly what had been copied and taken. Given that a compromised intelligence operation is a lethally dangerous one, shutters slammed down all over the world—including, probably, on some operations and agents whose identities were still secure. That, in itself, provided yet more useful clues for western spycatchers.

The World Was Going Our Way: The KGB and the Battle for the Third World
By Christopher Andrew and Vasili Mitrokhin



Basic Books; 678 pages; $29.95.
Published in Britain as "The Mitrokhin Archive II: The KGB and the World". Penguin/Allen Lane; £30

Buy it at
Amazon.com
Amazon.co.uk

How much more confusion was sown when a filleted selection of information about KGB operations in the West was published under Mitrokhin's name in 1999, the non-secret world will never know. The same applies to this second volume, which details Kremlin dirty tricks in the third world. As with the first, Mitrokhin has a co-author, Christopher Andrew, an historian who enjoys close ties with Britain's security and intelligence services.

Despite being written by such insiders, this book is curiously unsatisfying. Much of it is an elegantly presented narrative of information already in the public domain about Soviet mischief-making during the cold war. That is worth having. The extent to which Soviet spooks sponsored terrorists and spread lies about the West is known, but is not common knowledge. The world

tends to remember more about the misdeeds of the CIA.

In this nutritious but unexciting dough come little raisins of Mitrokhin's own revelations. Almost the first, a typical one, comes on page 50, where the reader learns that the Centre (ie, KGB headquarters) condemned the Nicaraguan Sandinistas' offensive in the summer of 1967 as premature. That is footnoted to “vol 6, chap 13, part 3”. But what the context might be, the reader can't know. The Mitrokhin archive is hidden deep in the green glass SIS fortress on the banks of the Thames in London. And that is where it is likely to stay.

That's a problem for a book that wants to be a serious history. A reader needs to feel that he or she can go to the source material and check to see if it is used fairly and accurately. Few do, but the knowledge of that scrutiny keeps historians honest. With this book there are three kinds of uncheckable possible distortion.

First, the KGB documents themselves must be true. Given the way that the Soviet Union was founded on lies and deceit, and given the incompetence of its bureaucracy, that is a big, though not ludicrous, assumption. Then the reader must be sure that Mitrokhin, writing in a great hurry, in great secrecy and in great danger, copied everything down right. And thirdly, we have to believe that MI6's chiefs wholly withstood the temptation to use the material even slightly selectively, for the purposes of disinformation. But then that's the problem with all factual books about intelligence. Secrets and lies may be fascinating to many, but they are hard to hammer into truthful form.

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It's time to go on a low-carbon diet.

Weapons inspection in Iraq

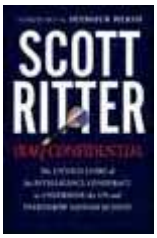
Mission unaccomplished

Oct 20th 2005
From The Economist print edition

Reuters

Bitter Ritter

Iraq Confidential: The Untold Story of the Intelligence Conspiracy to Undermine the UN and Overthrow Saddam Hussein
By Scott Ritter



Nation Books; 336 pages; $26.
I.B. Tauris; £17.99

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DURING the heyday of the UN Special Commission on Iraq (Unscom) in the 1990s, Scott Ritter was the most controversial of its weapons inspectors. His door-kicking tactics sometimes alarmed western governments as much as they incensed his Iraqi minders. But Mr Ritter felt he had a job to do, and it was not only the Iraqis who were getting in his way. The CIA, he argues in this memoir of the inspections, deliberately sabotaged not just some of his activities in Iraq but also Unscom itself. The American government wanted to see Iraq stripped of weapons of mass destruction, but only in pursuit of its real aim: to get rid of Saddam Hussein.

That last charge is hardly controversial. Senior American officials over the Unscom years (1991-

98), and famously Madeleine Albright as Bill Clinton's secretary of state, argued openly and with feeling (if unhelpfully at the time) that sanctions on Iraq should not be lifted until Mr Hussein, a serial re-offender, was levered from power. Many Iraqis lost their lives in coup plots, some of which had American backing, trying to do just that.

As for the role of foreign intelligence agencies, as Mr Ritter admits, Unscom was up to its neck in them. It had to be: Iraq's determination to hang on to its weapons secrets turned inspectors into forensic sleuths, reliant on the spies of America, Britain, Israel and others for clues, communications intercepts and analysis of aerial photographs. Mr Ritter is bitter that the CIA came to use Unscom as a cover to gather communications intercepts in Iraq for itself. That undermined Unscom's integrity. Yet he seems curiously incurious about the games others were playing: the Russians were heavily engaged, but on Iraq's side; the French, he claims, helped Iraq break Unscom's secret codes.

Unscom's integrity was also undermined by a plague of informants. And it could, admits Mr Ritter, be monumentally incompetent, on one occasion mistakenly sending details of a planned raid on a hidden document archive by courier to the Iraqis ahead of time. Unsurprisingly, the inspection proved a failure.

Could Iraq be expected to co-operate with inspections that were never likely to get sanctions lifted? A fair question, had Iraq shown inclination to co-operate at all. But, as Mr Ritter himself tells it, the Iraqis' own behaviour turned the question around: why would the outside world take on trust protestations that they had destroyed their weapons stocks in 1991 (which, for the most part, it later turned out they had), when they engaged in a massive cover-up to mislead inspectors? Unscom, concludes Mr Ritter, was trapped by Iraq's deceit. As, indeed, was Iraq itself.

Yet he is still among those who see the inspections as a success. That seems an odd conclusion when, without Iraqi co-operation, there was no way to tell whether it was covering up past nuclear, chemical, biological and missile programmes, or concealing current ones.

Why play it this way, when Iraq wanted sanctions lifted? Because, Mr Ritter concludes, Iraq wanted to hang on to enough documents, brains and militarily usable equipment to be able to restart banned weapons work once inspectors were gone. It was a tactic that Mr Ritter says he came close to exposing. Sadly for ordinary Iraqis, it was a self-defeating one, and the trigger for another war.

Iraq Confidential: The Untold Story of the Intelligence Conspiracy to Undermine the UN and Overthrow Saddam Hussein.
By Scott Ritter.
Nation Books; 336 pages; $26.
I.B. Tauris; £17.99

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It's time to go on a low-carbon diet.

New American fiction

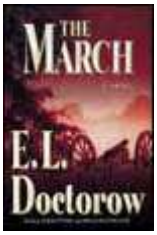
Marching through Georgia

Oct 20th 2005
From The Economist print edition

OF THE five novels recently shortlisted for America's 2005 National Book Award for fiction, “The March” may very well be the best. In his brilliant historical work about General William Tecumseh Sherman's notoriously vicious march through the South, E.L. Doctorow has brought the end of America's wretched civil war fearsomely to life. He portrays both the war itself—by far the most lethal conflict that the United States has ever fought—and Sherman's depredations as by turns inexorable and grotesquely gratuitous.

Like “Ragtime”, which first put Mr Doctorow in the public eye, “The March” employs real historical figures as fictional characters, in particular Sherman himself. Filling out the cast are a beautiful young freed slave who can pass for white, two gonzo rebel soldiers who, with the tide of the war turned, decide to pass for Union troops, and an emotionally cold but clinically brilliant Union surgeon, among a host of other walk-ons, both real and imagined.

The March
By E.L. Doctorow



Random House; 363 pages; $25.95. To be published in Britain by Little, Brown in January

Buy it at
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Still, the novel never feels overpopulated, but grandly panoramic. After all, Mr Doctorow is capturing a time when hundreds of thousands were on the march. Sherman's looting troops, who burn what they can't take with them, turn whole towns of southerners into refugees. Jubilant but destitute freed slaves trail their Union army liberators, who only wish the dratted Negroes would go away. Employing more than a handful of characters seems apt, and the fact that the abundance of those we follow throughout the novel are so fully realised is remarkable.

“The March” pulses with outrage, but lands its disgust generously on both sides of the Mason-Dixon line. Sherman's vengeful destruction and opportunistic thievery is so vivified as to well explain why much of the modern American South is still indignant a century and a half later. Likewise, Union fury at secessionists for having started the whole horror show in the first place is understandable.

Mr Doctorow's writing here is magnificent, the details he selects unerringly trenchant: “the wagon bumping over dead dogs—every hound to be seen was shot through the head.” One of the more odious army tasks is to “dig a pit for severed limbs,” for our Union surgeon is “renowned in the corps for removing a leg in twelve seconds. An arm took only nine.” Elsewhere, a crusty old southern gentleman growls to himself, “The wretched war had destroyed not only their country but all their presumptions of human self-regard. What a scant, foolish pretence was a family, a culture, a place in history, when it was all so easily defamed. And God was behind this. It was God

who did this, with the Union as his instrument."

Most of all, this novel is dominated by a despair at the jaw-dropping waste of it all, waste that leaves a lingering metallic taste in the mouth—like sucking on a bullet.

The March.
By E.L. Doctorow.
Random House; 363 pages; $25.95. To be published in Britain by Little, Brown in January

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The battle of Agincourt

Bowing to the longbow

Oct 20th 2005
From The Economist print edition

THE long, low ridges of the Somme, in northern France, are now synonymous with the senseless stalemate of the Western Front in 1916. But the exhausted, grimy English soldiers stumbling through this landscape, sinking up to their knees in mud, once wore kettle helmets and padded jerkins. Their weapons were not Tommy-guns but longbows, each six feet long and with a pull-weight of 150 pounds, strung with gut and equipped with arrows so finely barbed that they could pierce armour-plate. Their comfort behind the lines was not a cigarette, but prayers from a priest more scared than they were. One thing, however, was strangely the same: five centuries apart, they scrambled into battle to the cry, “Fellas, let's go!”

Agincourt: The King, the Campaign, the Battle
By Juliet Barker

Little, Brown; 460 pages; £20

Buy it at
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The Agincourt campaign, which reached its climax on October 25th 1415, was a strange affair. Henry V had invaded France to prove that large parts of it, including Gascony, Normandy, Anjou and Touraine, belonged to him as part of the “just rights and inheritances” of the crown of England. The claim was longstanding, intermittently invoked, but passionately defended. Henry took advantage of internal chaos in France, between the lords of Burgundy and Armagnac, to assert it again.

He did not claim the whole country, and probably wanted only to take control of the territories bordering the English Channel. His campaign, traced on a map, seems a rather desultory wander not very deep into France. After the siege of Harfleur, when he had pounded the town into submission with his newfangled guns (so new that they sometimes managed only one shot a day), Henry meant to march to Calais and then sail away. It all became much more arduous, and more glorious.

Even for such a limited campaign, the planning had to be extraordinary. Juliet Barker's splendid book omits no detail of this: bulk orders of arrows, in sheaves of 24, and of goose feathers, six from each goose; muster rolls of lords' retinues and personal indentures for war service; the hiring of Flemish ships and, above all, the raising of funds. About £69m, in today's money, was obtained from parliamentary subsidies, loans from merchants and corporations, the melting down of some gorgeous gold artefacts and, not least, the expedient of clapping foreign bankers in jail and making them pay to get out.

Ms Barker is a specialist in tournaments and chivalry, and this serves her excellently here. The Agincourt campaign was conducted from the beginning in strict accordance with the laws of war

and courtesy. At every point, Henry offered his enemies the chance to surrender with honour. Of course the French refused, because they thought they could win. Ms Barker pays tribute to a recent academic controversy over the numbers of men involved, but argues convincingly that 36,000 French faced 6,000 English, figures she derives from a herald on the French side. Although they outnumbered the English and were rested and fresh, the French soldiers were riven with disagreements among themselves (especially over who should be in the van and who not) and their men-at-arms, floundering in the mud, made easy prey for Henry's archers.

They also had no leader. The English had Henry, perhaps their best-ever king-commander. He was a stickler for discipline, even standing at the head of a ford to make sure his men crossed in good order. His first experience of warfare, at 16, had ended with an arrow piercing his left cheek as far as the bone at the back of the skull; it was removed with a hollow drill-bit, bigger than the wound, without anaesthesia. This had taught him stoic courage. But along with his strictness he was affable and kind, going the rounds of his men to encourage them, as Shakespeare depicted him. Ms Barker could be accused of liking Henry too much; he has no flaws, and even his ethnic cleansing of Harfleur is forgiven as militarily justified.

But there is certainly nothing else to reproach Ms Barker for. Her book is quite wonderfully vivid, clear and involving. She never forgets that a military campaign is made up of human beings. All the terror, dust and dirt of war is here—the numb, cold fingers fumbling with buckles and straps, the faces of the men-at-arms streaked brown from their rusted armour, the dysentery-ridden archers cutting away their breeches. The king, mounted on a small grey horse and without his heralds, rides out in the damp morning over the field of battle to see where he will deploy his men. Then, at his order, 5,000 English archers firing up to 20 arrows a minute fill the sky with death.

Agincourt: The King, the Campaign, the Battle.
By Juliet Barker.
Little, Brown; 460 pages; £20

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Asian cinema

Deep trouble

Oct 20th 2005 | BUSAN, SOUTH KOREA
From The Economist print edition

An Indian film stars at the world's biggest festival of Asian film

Getty Images

Now she can laugh

"WATER" is the third part of an elemental trilogy by Deepa Mehta, an Indian director with a reputation for liking hot potatoes. "Fire", one of her earlier films, tackled lesbianism, and "Earth", the still sensitive subject of India's partition.

In "Water", she turns to the plight of India's widows, who are often regarded as non-persons. Though *suttee* has been illegal for a long time, many widows still suffer under an extreme interpretation of a 2,000-year-old Hindu tradition whereby a wife is half of her husband and when he dies, she is in effect half-dead too, and should be consigned to an ashram or house of

confinement.

After the script of “Water” was passed by India's official censor in 2000, shooting began in the holy city of Varanasi in Uttar Pradesh. However, Hindu fundamentalists were quick to protest, burning down the main set and seizing and destroying all prints and the original negative of the film. With no insurance cover, Ms Mehta had to abandon her project. But she remained undaunted, and spent the next few years raising the money to shoot the film again. A Canadian businessman came to the rescue and “Water” was remade in Sri Lanka, using a bogus working title as a precaution. It also required a new cast since one of the leading characters, a child, had grown into an adolescent in the interim.

Was it all worth it? Absolutely. “Water” combines a humanist message, political courage and visual poetry in a way not seen since the death of Satyajit Ray. It is the finest Indian film for a generation.

The story is told through the eyes of a six-year-old girl who is sent to an ashram after the husband she had barely known suddenly dies. Still a child, all she craves is her mother, but even this is denied her. The child's story is paralleled with that of another widow, who falls in love with and expects to marry a high-caste idealist but commits suicide when his father advises him not to rock the boat and to take her as a mistress instead.

The film is set in the 1930s against India's growing independence movement, and its conclusion is more upbeat than you might expect. Mahatma Gandhi, on a stop at the local station, makes an impassioned call for reform which inspires the child-bride and the now bereaved lover to flee the town together and accompany Gandhi to a brighter future.

Like “La Terra Trema” and “The Battleship Potemkin”, “Water” uses great artistry to challenge orthodox views. It is in the grand humanist tradition of Ray, Ms Mehta's mentor, and Vittorio De Sica. The young girl who brings a wizened and dying widow a piece of fruit to see her safely into the next world is a tribute to Ray's first film “Pather Panchali”. Ms Mehta was applauded last week at the tenth Pusan film festival. Ray would have been proud.

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Finding Sustainable Energy Solutions

Obituary

Arthur Seldon

Oct 20th 2005
From The Economist print edition

Telegraph

Arthur Seldon, intellectual architect of both Blairism and Thatcherism, died on October 11th, aged 89

“THE ideas of economists and political philosophers...are more powerful than is commonly understood. Indeed, the world is ruled by little else. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back.” So wrote John Maynard Keynes, the economic architect of the welfare state and the Great Society, and he should have known. But it was Arthur Seldon who took Keynes's words to heart, and paid him back in kind. Mr Seldon marshalled the academic scribblers of his own era to lead the intellectual fight-back against Keynesianism, distilling from free-market economic doctrines ideas that fuelled both the frenzy of Thatcherism and its afterburn, Tony Blair.

The perch from which Mr Seldon directed this campaign was a think-tank, the Institute of Economic Affairs (IEA), which he joined as editorial director in 1958. The IEA was founded in 1955 by an old-Etonian chicken farmer called Antony Fisher. Concerned by the waves of nationalisations and economic controls in post-war Britain, Mr Fisher sought advice from the one intellectual who was resisting the tide, an Austrian-born economist, Friedrich von Hayek. Hayek urged him to emulate the Fabian Society, the first socialist think-tank, which had done so much to spread the

doctrine of state intervention at the beginning of the century. He should do so, however, from the opposite, free-market point of view.

Fisher's first recruit, as director of the new think-tank, was Ralph Harris, and his second was Mr Seldon. Together they made a formidable team, in place until the mid-1980s, by which time they had moved from the outer fringes to the mainstream of British politics. Mr Harris was the IEA's public face; Mr Seldon, the more thoughtful of the two, was its resident intellectual. A pronounced stutter meant that he seldom spoke in public. But as editorial director he oversaw the institute's highly influential publishing programme.

The IEA's pamphlets, modelled on Fabian ones, brought to the lay reader the ideas of all the leading free-market economists and thinkers of the day. Many of those subjects—reform of the trade unions, public versus private welfare, the virtues of floating exchange rates—became the main preoccupations of the Thatcherites in the 1980s. Mr Seldon's target audience was what he called the “second-hand dealers in ideas”: journalists, teachers, academics, businessmen and city analysts who create the intellectual environment in which politicians have to work.

Mr Seldon's golden rule was that his authors should think of their subjects regardless of the political context. They were to expound the verities of economic liberalism and let the politicians come to them, rather than the other way round. It took quite a long time for this to happen; but eventually, from the mid-1960s, the politicians began to arrive. As Britain's economic problems piled up, a trickle of radical Conservatives such as Enoch Powell, Margaret Thatcher and Geoffrey Howe started getting involved in the IEA's work, looking for free-market alternatives.

Mr Seldon, however, kept away from active politics. Having seen war service in Africa and Italy, he picked a military metaphor: the IEA would be the long-range artillery lobbing shells into enemy lines, “but it would never be the infantry, engaged in the short-term face-to-face grappling.” In the mid-1970s, as the Thatcherite revolution got under way, other think-tanks, such as the Centre for Policy Studies, were founded to do the grappling.

A classic liberal

In many ways Mr Seldon was a quintessential Thatcherite, if never a Conservative. He was born in the East End of London, to Russian-Jewish immigrants, but lost both parents in the 'flu epidemic of 1918, when he was three. Adopted by a cobbler, learning to repair shoes himself, he became a natural and lifelong believer in self-help. He won a state scholarship to the London School of Economics, where he was inspired to his life's work by Hayek, who was one of his tutors.

Rather than a Tory, Mr Seldon was essentially a classic liberal. Much of his early life was devoted to trying to revive the Gladstonian roots of the Liberal Party, even as it succumbed to the influence of Keynes and others. He always regretted that it was the Conservative Party that took up the IEA's agenda, not the Liberal Party, where his free-market ideas really belonged. This marked him out from most Thatcherites, who, much as they adored economic freedom, often had a Tory dislike of individual liberty in other spheres.

His distance from party politics made him a natural source of wisdom when the next generation of intellectuals came along, in the early 1990s, to try to end the hegemony of Conservatism. Copying Mr Seldon's formula, they started think-tanks such as Demos to create a new intellectual climate that would eventually contribute to Mr Blair's landslide election victory in 1997. Not only had Mr Seldon changed the way that politicians went about their business, establishing the “battle of ideas” as equal in importance to party politics. Through his tireless campaigning he had also ensured that New Labour would only be taken seriously if it became, essentially, a free-market party as well.

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MARKETS & DATA

WEEKLY INDICATORS

Overview

Oct 20th 2005
From The Economist print edition

Consumer prices in **America** soared by 1.2% in September, their biggest rise in 25 years, leaving prices 4.7% higher than a year earlier. The jump was mainly due to a 12% increase in energy costs. If fuel and food are excluded, monthly inflation reached only 0.1%, suggesting that higher energy bills have not yet passed through to core consumer items. The same discrepancy showed up in producer prices. Core prices rose by 0.3% in September against an increase of 1.9% if energy and food are included.

America's industrial production plunged by 1.3% in September, the largest decline since January 1982. The fall was blamed mostly on Hurricane Katrina and a strike at Boeing. Manufacturing output fell by 0.5%, while mining output, which includes offshore oil and gas production, dropped by 9.1%. Industrial production remained 2.0% higher in September than a year earlier.

The value of retail sales in **America** grew by a weaker than expected 0.2% in September, held back by a 2.8% drop in sales of motor vehicles and parts. But spending on items other than cars and gasoline increased by a sturdier 0.6%. The University of Michigan's consumer confidence survey in October casts a gloomier picture: the index of consumer sentiment fell to 75.4 from 76.9 in September, well below analysts' forecasts of 80.0.

The **euro area's** industrial output expanded by 0.8% in August, up from 0.1% in July, thanks to strong gains in France, Italy, Spain and Ireland. Consumer-price inflation jumped to 2.6% in the year to September, higher than the original estimate of 2.5%, and up from 2.2% in the year to August. Meanwhile, **Germany's** ZEW index of economic expectations improved by only 0.8 points to 39.4 in October.

Wholesale price inflation in **Japan** was 1.7% in the year to September, the same rate of increase as in the year to August. Although a large part of the increase was due to dearer petroleum products, prices of ferrous and non-ferrous metals rose as well.

Consumer-price inflation increased in **Britain** to 2.5% in the year to September, its fastest pace since the current index was launched in January 1997. With inflation well above its target of 2.0%, the Bank of England's Monetary Policy Committee will find it hard to cut interest rates. In the minutes of its last meeting, all nine members voted to keep borrowing costs steady at 4.5%.

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Output, demand and jobs

Oct 20th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q2	+ 5.2	+ 2.6	+ 3.3	+ 0.7	Q2	+ 1.6	Q2	5.1	Sep	5.5
Austria	+ 2.1	Q2	+ 1.8	+ 1.8	+ 2.0	+ 5.4	Jul	– 1.5	Jul	5.2	Sep	4.9
Belgium	+ 1.5	Q2	+ 1.2	+ 1.3	+ 1.7	– 2.3	Aug	+ 6.7	Jul	13.5	Sep†	13.2
Britain	+ 1.5	Q2	+ 2.0	+ 1.9	+ 2.1	– 1.9	Aug	+ 0.7	Sep	4.7	Aug‡	4.7
Canada	+ 2.7	Q2	+ 3.2	+ 2.9	+ 3.0	+ 0.6	Jul	+ 6.7	Jul	6.7	Sep	7.0
Denmark	+ 4.3	Q2	+ 6.6	+ 2.0	+ 2.1	+ 0.1	Aug	+ 4.9	Aug	5.7	Aug	6.4
France	+ 1.3	Q2	+ 0.5	+ 1.4	+ 1.6	+ 2.0	Aug	+ 4.1	Aug	9.9	Aug	10.0
Germany	+ 0.6	Q2	nil	+ 0.9	+ 1.1	+ 2.1	Aug	+ 2.2	Aug	11.7	Sep§	10.7
Italy	+ 0.1	Q2	+ 2.7	nil	+ 0.9	+ 6.1	Aug	– 1.6	Jul	7.7	Jun	8.1
Japan	+ 1.4	Q2	+ 3.3	+ 2.2	+ 2.0	+ 1.5	Aug	+ 0.9	Jul	4.3	Aug	4.8
Netherlands	+ 1.3	Q2	+ 4.9	+ 0.6	+ 1.6	– 0.3	Aug	+ 0.7	Jul	6.6	Sep**	6.1
Spain	+ 3.4	Q2	+ 3.4	+ 3.3	+ 2.9	+ 3.8	Aug	+ 3.1	Aug	9.4	Aug	10.8
Sweden	+ 2.3	Q2	+ 2.6	+ 2.3	+ 2.7	– 4.0	Aug	+ 6.2	Aug	5.4	Sep†	5.8
Switzerland	+ 1.0	Q2	+ 1.1	+ 1.1	+ 1.6	+ 3.9	Q2	+ 4.7	Aug	3.6	Sep†	3.7
United States	+ 3.6	Q2	+ 3.3	+ 3.5	+ 3.2	+ 2.0	Sep	+ 5.0	Aug	5.1	Sep	5.4
Euro area	+ 1.1	Q2	+ 1.2	+ 1.2	+ 1.5	+ 2.6	Aug	+ 2.0	Aug	8.6	Aug	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.2	Q2	– 6.3	na	na	– 3.9	Aug	+ 5.8	Aug	8.2	Aug	9.0
Greece	+ 3.7	Q2	na	na	na	+ 1.4	Aug	+ 4.0	Jul	9.9	Mar	10.8
Iceland	+ 6.8	Q2	na	na	na	na		na		1.8	Aug†	2.9
Ireland	+ 4.1	Q2	+ 6.5	na	na	+16.6	Aug	+ 4.2	Aug	4.4	Sep	4.4
Luxembourg	+ 3.1	Q1	na	na	na	+15.7	Jul	– 4.4	Aug	4.5	Aug	4.0
New Zealand	+ 2.6	Q2	+ 4.5	na	na	+ 3.5	Q4	+ 5.9	Q2	3.7	Q2	4.0
Norway	+ 4.8	Q2	+ 5.2	na	na	+ 9.5	Aug	+ 5.1	Aug	4.8	Aug**	4.5
Portugal	+ 0.5	Q2	+ 4.1	na	na	– 0.8	Jul	+ 1.4	Aug	7.2	Q2†	6.3

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Jun-Aug; claimant count rate 2.8% in Sep.
§EU harmonised rate 9.3% in Aug. **Jul-Sep.

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It's time to go on a low-carbon diet.
Roll over to expand ▼
bp beyond

Prices and wages

Oct 20th 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2005	2006	latest		year ago	latest		year ago
Australia	+ 2.5	Q2	+ 2.5	+ 2.6	+ 2.7	+ 6.9	Q2	+ 2.8	+ 5.8	Q2	+ 3.0
Austria	+ 2.4	Sep	+ 2.1	+ 2.2	+ 2.0	+ 1.5	Sep	+ 6.0	+ 2.3	Sep	+ 2.0
Belgium	+ 3.2	Sep	+ 2.0	+ 2.5	+ 2.2	+ 1.8	Aug	+ 5.9	+ 2.5	Jul	+ 2.2
Britain	+ 2.5	Sep*	+ 1.1	+ 2.1	+ 2.2	+ 3.3	Sep	+ 3.1	+ 4.2	Aug†	+ 3.8
Canada	+ 2.6	Aug	+ 1.9	+ 2.3	+ 2.4	– 0.4	Aug	+ 5.5	+ 1.4	Jul	+ 1.5
Denmark	+ 2.4	Sep	+ 1.1	+ 1.6	+ 1.9	+ 5.3	Sep	+ 3.4	+ 2.9	Q2	+ 3.1
France	+ 2.2	Sep	+ 2.1	+ 2.0	+ 1.7	+ 2.8	Aug	+ 2.8	+ 2.9	Q2	+ 2.8
Germany	+ 2.5	Sep	+ 1.8	+ 1.9	+ 1.8	+ 3.6	Sep	+ 3.4	+ 1.3	Jul	+ 0.4
Italy	+ 2.0	Sep	+ 2.1	+ 2.2	+ 2.1	+ 3.7	Aug	+ 3.5	+ 2.9	Aug	+ 2.6
Japan	– 0.3	Aug	– 0.2	– 0.1	+ 0.3	+ 1.7	Sep	+ 1.9	– 2.7	Aug	+ 2.8
Netherlands	+ 1.8	Sep	+ 1.0	+ 1.5	na	+ 4.9	Aug	+ 5.5	+ 1.0	Sep	+ 0.9
Spain	+ 3.7	Sep	+ 3.2	+ 3.2	+ 3.1	+ 4.9	Aug	+ 4.4	+ 3.4	Q2	+ 3.1
Sweden	+ 0.6	Sep	+ 0.6	+ 0.7	+ 1.5	+ 4.2	Aug	+ 2.0	+ 2.5	Jul	+ 3.4
Switzerland	+ 1.4	Sep	+ 0.9	+ 1.2	+ 1.2	+ 1.5	Sep	+ 1.5	+ 0.9	2004	+ 1.4
United States	+ 4.7	Sep	+ 2.5	+ 3.2	+ 3.0	+ 6.7	Sep	+ 3.3	+ 2.6	Sep	+ 2.4
Euro area	+ 2.6	Sep	+ 2.1	+ 2.2	+ 1.9	+ 4.0	Aug	+ 3.1	+ 2.3	Q2	+ 2.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.2	Sep	+ 0.4	na	na	+ 3.8	Sep	+ 2.5	+ 4.0	Q2	+ 3.8
Greece	+ 3.9	Sep	+ 2.7	na	na	+ 5.5	Aug	+ 4.9	na		na
Iceland	+ 4.6	Oct	+ 3.7	na	na	+ 4.6	Sep	+ 5.2	+ 6.7	Aug	+ 5.2
Ireland	+ 3.0	Sep	+ 2.5	na	na	– 1.1	Aug	– 0.4	+ 3.4	Q2	+ 4.3
Luxembourg	+ 2.9	Sep	+ 2.0	na	na	+ 4.1	Aug	+11.3	+ 0.7	Jul	+ 2.2
New Zealand	+ 3.4	Q3	+ 2.5	na	na	+ 4.7	Q2	+ 1.5	+ 2.6	Q2	+ 2.3
Norway	+ 2.0	Sep	+ 1.1	na	na	+17.9	Sep	+20.3	+ 3.8	Q2	+ 4.1
Portugal	+ 2.8	Sep	+ 2.1	na	na	+ 4.4	Aug	+ 4.0	nil	Aug	– 2.2

*RPI inflation rate 2.7% in Sep. †Jun-Aug.

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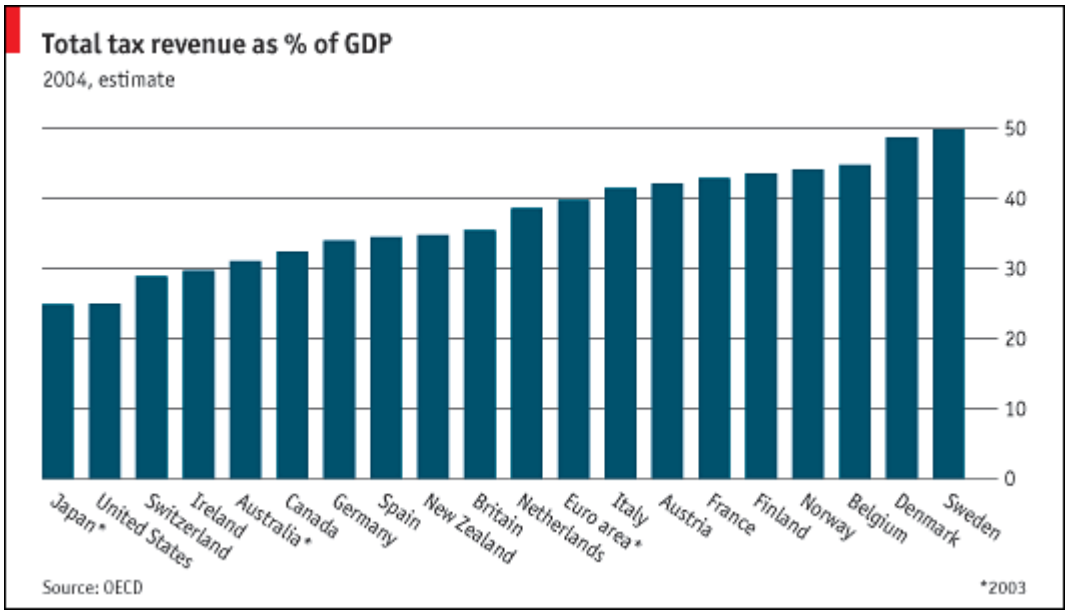
Total tax revenue as % of GDP

Oct 20th 2005
From The Economist print edition

Sweden's government collects more tax revenue relative to the size of its economy than any other rich country. According to the OECD, Sweden's government took in the equivalent of 50% of GDP in 2004. That is almost twice as high as the total tax revenue in America and Japan, which both collect around 25% of GDP. In the euro area, tax revenue, on average, reaches 40% of GDP.



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Money and interest rates

Oct 20th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Oct 19th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 5.6	+ 8.6	Aug	5.62	5.40	5.27	5.40	5.34	6.40
Britain	+ 5.4	+11.2	Sep	4.53	4.84	4.24	4.37	4.75	5.17
Canada	+ 7.4	+ 9.7	Aug	3.03	2.56	3.51	4.10	4.51	5.26
Denmark	+20.7	+14.8	Aug	2.20	2.25	2.42	3.18	3.95	4.89
Japan	+ 5.2	+ 2.1	Sep	0.02	0.03	0.25	1.50	1.49	1.64
Sweden	+ 2.5	+ 6.2	Aug	1.47	2.01	2.15	3.13	4.19	2.93
Switzerland	+ 3.2	+ 6.3	Sep	0.80	0.69	1.31	1.96	2.45	1.96
United States	+ 0.3	+ 6.6	Sep	3.95	1.91	4.24	4.46	4.04	5.45
Euro area†	+11.5	+ 8.1	Aug	2.19	2.14	2.45	3.23	3.87	3.58

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.69%, Japan No. 273 1.51%. Central bank rates: US fed funds 3.75%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 20th 2005
From The Economist print edition

2000=100

	Oct 11th	Oct 18th*	% change on one month	% change on one year
Dollar index				
All items	135.5	136.3	+ 3.4	+13.2
Food	124.3	124.8	+ 2.4	+ 9.8
Industrials				
All	149.9	151.2	+ 4.6	+17.1
Nfa†	135.8	136.0	+ 1.2	+12.0
Metals	157.6	159.5	+ 6.2	+19.6
Sterling index				
All items	117.7	118.3	+ 6.8	+16.9
Euro index				
All items	104.5	105.7	+ 5.6	+18.8
Yen index				
All items	143.9	146.5	+ 7.5	+20.9
Gold				
$ per oz	476.40	472.50	+ 1.4	+12.6
West Texas Intermediate				
$ per barrel	63.50	63.03	– 4.5	+18.6

* Provisional. † Non-food agriculturals.

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Stockmarkets

Oct 20th 2005
From The Economist print edition

Market indices

	Oct 19th	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,345.9	4,617.4	3,905.5	– 1.9	– 5.9	+ 7.2	+ 2.5
Austria (ATX)	3,155.0	3,503.9	2,415.0	– 5.8	–10.0	+29.8	+14.4
Belgium (Bel 20)	3,238.8	3,373.8	2,958.8	– 2.7	–12.0	+10.4	– 2.6
Britain (FTSE 100)	5,167.9	5,501.6	4,783.6	– 3.3	–25.4	+ 7.3	– 1.5
Canada (Toronto Composite)	10,425.8	11,081.2	9,006.2	– 0.6	– 8.5	+12.8	+14.9
Denmark (OMXCB)	320.6	341.9	257.8	– 5.3	– 6.2	+24.4	+ 9.3
France (SBF 250)	3,051.0	3,248.3	2,633.6	– 3.4	–30.5	+15.8	+ 2.1
(CAC 40)	4,375.1	4,650.2	3,816.1	– 3.1	–36.8	+14.5	+ 1.0
Germany (DAX)*	4,846.0	5,138.0	4,178.1	– 2.7	–39.9	+13.9	+ 0.4
Italy (S&P/MIB)	32,279.0	34,874.0	30,645.0	– 3.4	–35.6	+ 4.5	– 7.9
Japan (Nikkei 225)	13,129.5	13,738.8	10,825.4	– 2.5	–66.3	+14.3	+ 1.4
(Topix)	1,379.8	1,428.1	1,109.2	– 1.9	–52.2	+20.0	+ 6.4
Netherlands (AEX)	387.1	408.7	347.0	– 1.7	–44.8	+11.2	– 2.0
Spain (Madrid SE)	1,119.7	1,176.9	950.9	– 3.3	– 4.9	+16.7	+ 2.9
Sweden (Affarsvarlden Gen)	259.1	273.7	218.9	– 3.1	–35.3	+17.1	– 1.4
Switzerland (Swiss Market)	6,820.4	7,042.3	5,669.6	– 1.4	–18.9	+19.8	+ 5.1
United States (DJIA)	10,414.1	10,940.6	10,012.4	+ 1.9	–11.2	– 3.4	– 3.4
(S&P 500)	1,195.8	1,245.0	1,137.5	+ 1.5	–21.7	– 1.3	– 1.3
(NASDAQ Comp)	2,091.2	2,218.2	1,904.2	+ 2.6	–58.6	– 3.9	– 3.9
Europe (FTSEurofirst 300)†	1,172.7	1,242.0	1,038.6	– 2.6	–31.2	+12.6	– 0.7
Euro area (FTSE Euro 100)†	998.7	1,056.1	894.4	– 2.6	–35.6	+10.8	– 2.3
World (MSCI)‡	1,175.3	1,225.6	1,115.0	– 0.6	–18.9	+ 0.5	+ 0.5
World bond market (Citigroup)††	624.7	662.3	621.5	– 0.5	– 5.7	– 6.2	– 6.2

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Oct 20th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Oct 19th	year ago	Currency units per $ Oct 19th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 16.4	Aug	− 43.1	Q2	− 4.8	− 4.4	117.9	112.0	1.33	1.36	2.35	1.60	1.15	+ 0.9
Austria	− 1.4	Jul	nil	Jul	− 0.4	− 0.6	104.1§	103.9	0.83	0.79	1.47	–	0.72	− 2.0
Belgium	+ 16.3	Aug	+ 9.2	Jun	+ 2.8	+ 2.7	104.7§	104.4	0.83	0.79	1.47	–	0.72	− 0.5
Britain	−115.6	Aug	− 23.5	Q2	− 2.4	− 2.5	99.0	98.7	0.57	0.55	–	0.68	0.49	− 2.9
Canada	+ 45.6	Aug	+ 16.3	Q2	+ 1.6	+ 1.5	123.4	115.7	1.18	1.24	2.07	1.41	1.02	+ 1.2
Denmark	+ 9.9	Aug	+ 9.7	Aug	+ 2.9	+ 2.7	105.8	106.4	6.23	5.90	11.0	7.46	5.39	+ 1.8
France	− 27.1	Aug	− 25.9	Aug	− 0.8	− 0.8	107.3§	106.9	0.83	0.79	1.47	–	0.72	− 3.0
Germany	+200.2	Aug	+110.4	Aug	+ 3.7	+ 3.5	105.1§	104.7	0.83	0.79	1.47	–	0.72	− 3.5
Italy	− 8.8	Aug	− 25.4	Jul	− 1.4	− 1.5	76.8§	76.6	0.83	0.79	1.47	–	0.72	− 4.4
Japan	+104.9	Aug	+163.7	Aug	+ 3.4	+ 3.3	83.2	87.3	116	108	204	138	–	− 6.1
Netherlands	+ 40.3	Aug	+ 28.3	Q2	+ 3.7	+ 3.6	104.2§	103.8	0.83	0.79	1.47	–	0.72	− 2.2
Spain	− 90.6	Jul	− 75.2	Jun	− 6.1	− 6.0	77.4§	77.2	0.83	0.79	1.47	–	0.72	+ 0.5
Sweden	+ 21.4	Aug	+ 27.9	Q2	+ 7.1	+ 6.6	94.6	99.9	7.89	7.19	13.9	9.46	6.83	+ 0.8
Switzerland	+ 7.0	Aug	+ 51.4	Q2	+11.4	+10.9	106.3	107.9	1.30	1.22	2.28	1.55	1.12	− 1.0
United States	−737.4	Aug	−749.7	Q2	− 6.5	− 6.6	86.6	84.4	–	–	1.76	1.20	0.87	− 4.1
Euro area	+ 54.3	Jul	+ 10.3	Jul	+ 0.2	+ 0.2	115.6	117.5	0.83	0.79	1.47	–	0.72	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 11.4	Aug	+ 7.7	Aug	na	na	81.7§	81.5	0.83	0.79	1.47	–	0.72	+ 1.3
Greece	− 33.8	Aug	− 16.2	Aug	na	na	60.0§	59.9	0.83	0.79	1.47	–	0.72	− 3.8
Iceland	− 1.1	Aug	− 1.6	Q2	na	na	105.1**	95.9	60.7	69.4	107	72.8	52.5	+ 1.1
Ireland	+ 40.3	Aug	− 3.9	Q2	na	na	94.6§	93.9	0.83	0.79	1.47	–	0.72	− 0.7
Luxembourg	− 4.4	Jul	+ 3.5	Q2	na	na	104.7§	104.4	0.83	0.79	1.47	–	0.72	− 0.8
New Zealand	− 4.0	Aug	− 8.2	Q2	na	na	139.4	134.4	1.43	1.44	2.52	1.72	1.24	+ 3.2
Norway	+ 44.6	Sep	+ 40.8	Q2	na	na	112.1	106.2	6.51	6.53	11.5	7.80	5.63	+ 14.4
Portugal	− 14.0	Jul	− 15.7	Jul	na	na	93.4**	93.4	0.83	0.79	1.47	–	0.72	− 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

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Metal prices

Oct 20th 2005
From The Economist print edition

Our metals index is at its highest level for nearly 17 years. Strong demand from China and speculative purchases by investment funds continue to push up prices. Copper prices are at a record; zinc is at an eight-year high.

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Overview

Oct 20th 2005
From The Economist print edition

China's foreign-exchange reserves jumped by $58 billion in the three months to September to $769 billion. That left them 50% higher than a year ago. The country's GDP grew by 9.4% in the year to the third quarter.

India's trade deficit widened to a record $35.5 billion in the year to September. **Singapore's** trade surplus narrowed to $16.8 billion over the same period.

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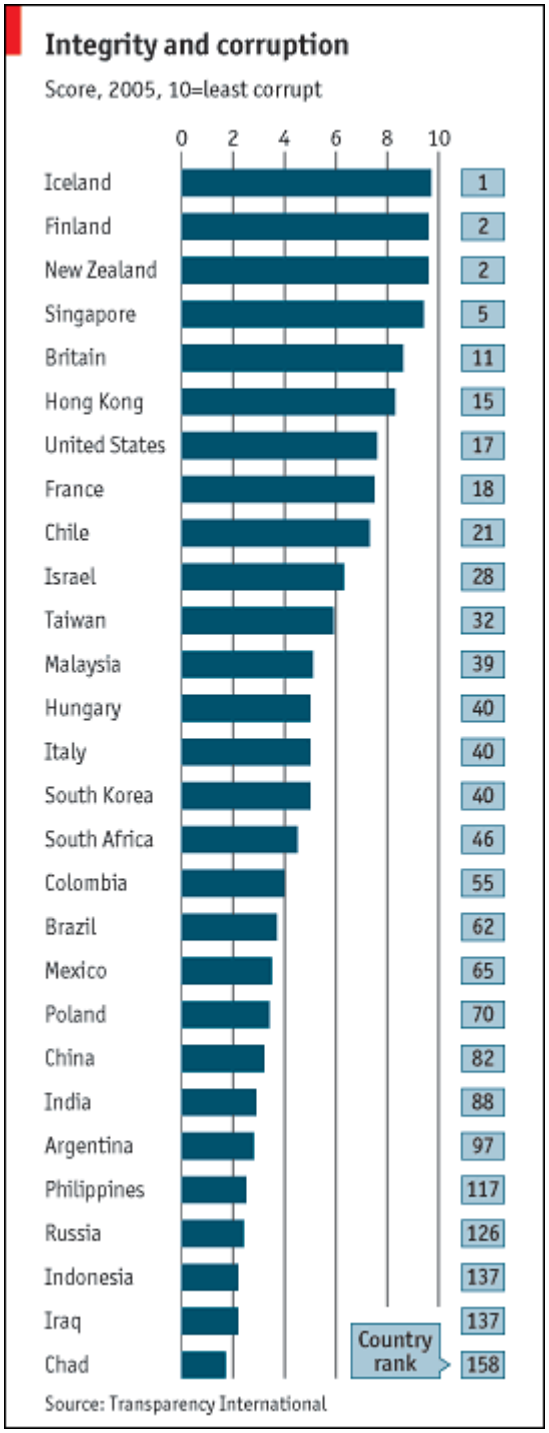
Integrity and corruption

Oct 20th 2005
From The Economist print edition

Each year, Transparency International draws on surveys of businessmen and country experts to gauge perceptions of corruption in 159 countries around the world. It defines corruption as the abuse of public office for private gain. This year, Chad shared the bottom slot with Bangladesh. Corruption has declined significantly over the past year in a number of countries, including France, Hong Kong, Taiwan and Nigeria.



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Economy

Oct 20th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.4	Q3	+16.5	Sep	+ 0.9	Sep	+96.4	Sep	+68.7	2004	769.0	Sep
Hong Kong	+ 6.8	Q2	– 0.1	Q2	+ 1.3	Aug	– 9.7	Aug	+21.3	Q2	122.3	Sep
India	+ 8.1	Q2	+ 7.4	Aug	+ 3.4	Aug	–35.5	Sep	–16.0	Q2	132.2	Sep
Indonesia	+ 5.5	Q2	+ 7.3	Jul	+ 9.1	Sep	+27.2	Aug	+ 4.0	Q2	29.9	Aug
Malaysia	+ 4.1	Q2	+ 4.1	Aug	+ 3.4	Sep	+24.1	Aug	+18.0	Q2	79.5	Aug
Philippines	+ 4.8	Q2	– 1.1	Jul	+ 7.0	Sep	– 0.7	Jul	+ 2.9	Mar	16.0	Sep
Singapore	+ 6.0	Q3	+11.8	Aug	+ 0.7	Aug	+16.8	Sep	+32.5	Q2	115.6	Sep
South Korea	+ 3.3	Q2	+ 5.5	Aug	+ 2.7	Sep	+25.2	Sep	+19.9	Aug	206.7	Sep
Taiwan	+ 3.0	Q2	+ 5.9	Aug	+ 3.1	Sep	+ 1.7	Sep	+13.3	Q2	253.8	Sep
Thailand	+ 4.4	Q2	+10.7	Aug	+ 6.0	Sep	– 7.3	Aug	– 2.3	Aug	48.2	Aug
Argentina	+10.1	Q2	+ 6.0	Aug	+10.3	Sep	+11.4	Aug	+ 2.8	Q1	24.8	Sep
Brazil	+ 3.9	Q2	+ 3.8	Aug	+ 6.0	Sep	+41.2	Sep	+12.5	Aug	54.6	Aug
Chile	+ 6.5	Q2	+ 4.5	Aug	+ 3.9	Sep	+ 8.9	Sep	+ 0.6	Q2	15.7	Sep
Colombia	+ 5.3	Q2	– 0.2	Jul	+ 5.0	Sep	+ 1.7	Jul	– 0.8	Q2	14.8	Sep
Mexico	+ 3.1	Q2	+ 2.1	Aug	+ 3.5	Sep	– 9.6	Aug	– 8.4	Q2	68.2	Aug
Peru	+ 6.7	Aug	+ 9.4	Aug	+ 1.1	Sep	+ 4.0	Jul	+ 0.4	Q2	12.8	Sep
Venezuela	+11.1	Q2	+ 8.0	Jul	+15.9	Sep	+24.7	Q2	+17.7	Q2	24.7	Jul
Egypt	+ 5.2	Q1	+ 3.3	2004†	+ 4.7	Aug	–10.4	Q2	+ 2.9	Q2	19.0	Aug
Israel	+ 4.8	Q2	+ 3.6	Jul	+ 1.9	Sep	– 7.7	Aug	+ 1.3	Q2	28.5	Sep
South Africa	+ 4.5	Q2	+ 3.5	Aug	+ 3.9	Aug	– 2.4	Aug	– 8.6	Q2	17.6	Sep
Czech Republic	+ 5.1	Q2	+ 8.6	Aug	+ 2.2	Sep	+ 1.4	Aug	– 4.1	Q2	29.9	Sep
Hungary	+ 4.1	Q2	+ 6.9	Aug	+ 3.7	Sep	– 3.4	Jul	– 8.6	Q2	17.5	Sep
Poland	+ 2.8	Q2	+ 5.5	Sep	+ 1.8	Sep	– 3.6	Aug	– 0.5	Aug	39.9	Aug
Russia	+ 6.1	Q2	+ 5.2	Sep	+12.4	Sep	+113.4	Aug	+78.3	Q2	159.6	Sep
Turkey	+ 4.2	Q2	+ 8.3	Aug	+ 8.0	Sep	–40.4	Aug	–20.7	Aug	41.2	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 9.9	Q2	+ 5.5	Aug	+ 4.9	Sep	– 2.3	Jul	– 1.4	Aug	1.8	Aug
Latvia	+11.6	Q2	+ 8.9	Aug	+ 7.2	Sep	– 2.8	Aug	– 1.7	Aug	2.2	Aug
Lithuania	+ 8.0	Q2	na		+ 2.6	Sep	– 3.2	Aug	– 1.5	Aug	3.5	Aug
Slovakia	+ 5.1	Q2	+ 4.3	Aug	+ 2.2	Sep	– 1.9	Aug	– 2.4	Jun	15.4	Aug
Slovenia	+ 5.2	Q2	+ 1.4	Aug	+ 3.2	Sep	– 1.3	Aug	+ 0.2	Aug	8.1	Jun
Pakistan	+ 8.4	2005†	+13.6	Apr	+ 8.5	Sep	– 7.9	Sep	– 1.5	Q2	10.6	Jun
Saudi Arabia	+ 6.5	2005	na		+ 0.3	Jul	+84.9	2004	+51.5	2004	24.8	Aug

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Oct 20th 2005
From The Economist print edition

	Currency units per $ Oct 19th	Currency units per $ year ago	Currency units per £ Oct 19th	Interest rates short-term % a year	Stockmarkets Oct 19th	% change on one week	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
China	8.09	8.28	14.3	2.00	1,192.3	-2.3	- 10.4	- 8.3
Hong Kong	7.76	7.79	13.7	4.24	14,372.8	-1.4	+ 1.0	+ 1.2
India	45.1	45.7	79.5	5.47	7,971.1**	-6.7	+ 20.7	+ 16.3
Indonesia	10,100	9,080	17,791	13.80	1,075.9	-2.5	+ 7.6	- 1.1
Malaysia	3.77	3.80	6.65	2.91	914.2	-1.5	+ 0.7	+ 1.5
Philippines	55.8	56.3	98.2	7.44	1,954.3	-0.2	+ 7.2	+ 7.9
Singapore	1.70	1.67	2.99	2.43	2,218.1	-4.4	+ 7.4	+ 3.4
South Korea	1,055	1,143	1,858	3.90	1,153.1	-5.3	+ 28.7	+ 26.4
Taiwan	33.7	33.8	59.3	1.55	5,694.2	-4.9	- 7.3	- 12.7
Thailand	41.0	41.3	72.2	4.15	684.1	-3.5	+ 2.4	- 2.9
Argentina	2.97	2.97	5.24	4.93	1,601.6	-0.2	+ 16.4	+ 16.4
Brazil	2.25	2.89	3.96	19.45	29,297.0**	-4.3	+ 11.8	+ 32.1
Chile	538	618	947	4.20	10,001.3	-0.1	+ 11.6	+ 15.3
Colombia	2,284	2,559	4,023	6.51	7,030.4	+3.7	+ 61.8	+ 66.6
Mexico	10.9	11.5	19.2	8.88	15,112.0	+0.1	+ 17.0	+ 19.9
Peru	3.39	3.32	5.97	3.03	4,954.4	-2.0	+ 33.5	+ 29.1
Venezuela	2,871§	2,530§	5,057	11.37	20,377.0**	+4.4	- 32.0	- 38.9
Egypt	5.76	6.25	10.15	9.32	48,088.2	-2.4	+ 95.6	+106.1
Israel	4.64	4.44	8.18	4.07	736.4**	-3.6	+ 14.4	+ 6.4
South Africa	6.59	6.31	11.6	7.15	15,539.6	-4.9	+ 22.8	+ 5.0
Czech Republic	24.8	25.0	43.7	1.91	1,308.8	-7.3	+ 26.8	+ 14.1
Hungary	211	196	372	6.06	19,703.7	-11.3	+ 33.7	+ 14.2
Poland	3.26	3.41	5.74	4.52	31,271.9	-4.9	+ 17.4	+ 8.0
Russia	28.6	29.1	50.4	13.00	882.1‡	-8.8	+ 48.2	+ 43.6
Turkey	1.37	1.49	2.41	15.61	30,766.7	-7.1	+ 23.2	+ 21.3
EM (MSCI)*	1.00	1.00	1.76	na	603.7	-5.2	+ 11.4	+ 11.4
EMBI+†	1.00	1.00	1.76	na	352.9	+0.3	+ 7.1	+ 7.1

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **Oct 11th.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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